Economic Outlook and Fiscal Review

ONTARIO 1989

Ontario

Ministry of
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Economics

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TABLE OF CONTENTS

Ontario Economic Outlook 1
Ontario Economic Outlook: The Transition to Sustainable Growth 2
Recent Performance: Growth Continues 2
Key Assumptions: 1990 4
The Outlook for 1990: More Moderate Growth and Inflation 7
The Medium-Term Outlook for 1991-1993 13
Labour Force and Employment 16
The Outlook for 1990 16
The Labour Force 16
Employment 19
Unemployment 20
Skilled Labour Requirements 22
Compensation Trends 22
The Sectoral Outlook 26
Overview 26
Agriculture 27
Resource and Resource-Based Industries 29
Transportation Equipment 30
Investment Goods 32
Intermediate Products 33
Consumer Products Industries 34
Construction 35
Utilities 36
Service Sector 36
Ontario's Position in a Changing World Economy 39
The International Context 39
Ontario's International Trade 39
International Comparisons 41

Ontario Fiscal Review 48
Revenue Profile 48
Composition of Provincial Revenues 48
Recent Developments in Revenue Policy 49
Canadian Tax Reform 49
Health Care Financing Reform 49
Transportation Capital Financing Plan 51
Environmental Initiatives 52
Description of the Major Taxation Sources 53
Per Point Yields 56
Interprovincial Tax Rate Comparisons 58
Tax Expenditures 60
Expenditure Profile 62
Health Care 63
Social Services and Income Support 64
Transfer Payments 65
Non-Transfer Payment Expenditures 66

Capital 66
Summary of Expenditures 67
Spending Control 67
Savings and Constraints Measures 67
Expenditure Indicators 68
Fiscal Indicators 69
Medium-Term Fiscal Outlook 74
Factors Influencing Expenditure Growth 74
Factors Influencing Revenue Growth 74
Fiscal Projection 75
Debt and Debt Financing 78
Ontario's Debt 78
Consolidated Public Sector Debt 79
Hydro Borrowing 79
Interprovincial Debt Comparison 80
Ontario's Financing 81
Ontario's Maturing Debt 81
Credit Worthiness 82
Federal-Provincial Funding Programs 84
Federal-Provincial Fiscal Arrangements 84
Canadian Assistance Plan 88
Canada Child Care Act 89
Provincial-Local Transfers 90
Transfers to Municipalities 90
Appendices 98
Appendix I: Tax Expenditures 99
Appendix II: Fiscal Capacity and Tax Effort 108
Appendix III: Glossary of Terms 112
Review of Selected Financial and Economic Statistics 118

Preface

In Spring 1986, the Legislature set up the Standing Committee on Finance and Economic Affairs to "consider and report to the House its observations on the fiscal and economic policies of the Province." The 1989 Economic Outlook and Fiscal Review is part of the Government's efforts to assist the Committee in its endeavours and to enhance the process of public consultation leading to the development of the 1990 Ontario Budget.

THE ONTARIO ECONOMIC OUTLOOK

Ontario Economic Outlook at a Glance **Table 1**

	1988	1989	1990
Real Growth (%)	5.6	2.8	2.0
Job Creation (000s)	173	90	71
Unemployment Rate (%)	5.0	5.1	5.5
Inflation (%)	4.7	5.9	5.3

In 1989 the Ontario economy began a transition to more moderate and sustainable growth, following six years of rapid expansion.

The economy is expected to continue to expand in 1990, but at a more modest pace than in recent years. Smaller employment gains and a stable savings rate will continue to restrain spending growth compared to the 1985-1988 period.

Ontario's economy is expected to generate 71,000 new jobs, following employment growth of 90,000 in 1989. The unemployment rate in 1990 is expected to rise four-tenths of a percentage point to 5.5 per cent. Ontario will continue to have the lowest unemployment rate among the provinces.

Inflation is expected to decline in 1990, reflecting the effect of more moderate growth in employment and output.

Ontario Economic Outlook: The Transition to Sustainable Growth

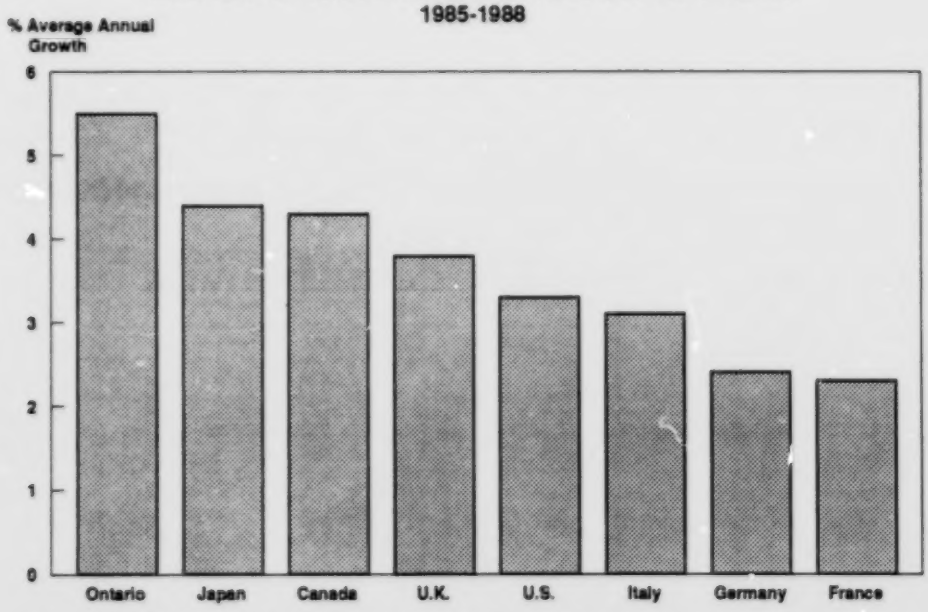
Recent Performance: Growth Continues

In 1989 the Ontario economy entered a period of more moderate growth, with output increasing by an estimated 2.8 per cent and employment by 1.9 per cent. This moderation reflects slower demand growth throughout the industrial world and the absorption of unused resources over the past several years.

Ontario emerged from the 1981-1982 recession with substantial unemployed labour, excess plant capacity, significant pent-up demand for consumer durables and housing, and a high level of savings. These factors made possible the rapid growth in output and employment through the first six years of the expansion.

Real output returned to its pre-recession peak in 1984. Between 1985 and 1988, real output in Ontario grew by an average 5.5 per cent per year, and employment increased by 3.5 per cent annually. In both output and employment, Ontario experienced higher growth than any of the major industrialized countries.

INTERNATIONAL COMPARISON OF REAL OUTPUT GROWTH
1985-1988



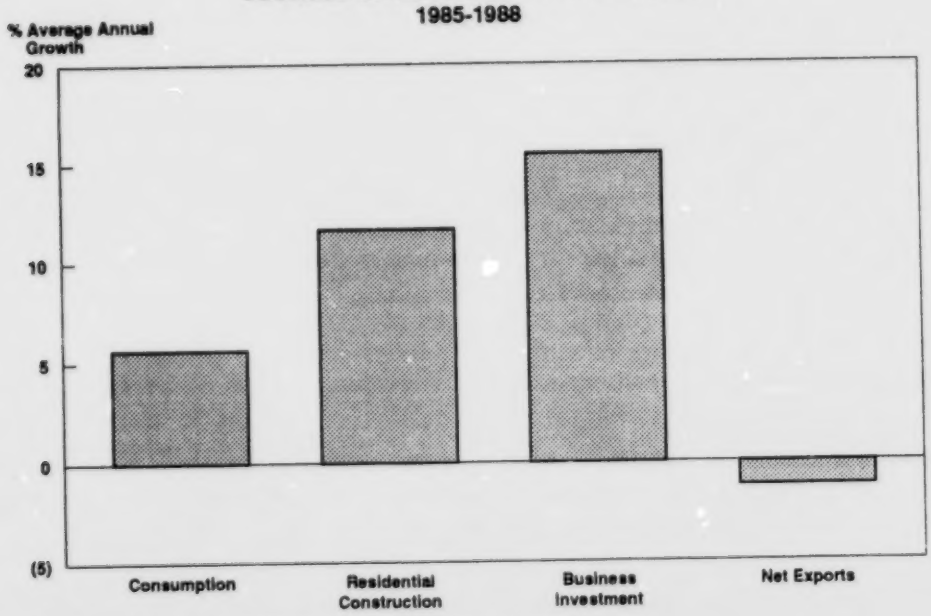
Source: I.M.F., Statistics Canada and Ontario Ministry of Treasury and Economics.

Consumer spending and exports were the fastest growing components of aggregate demand during the 1983-1984 period. By contrast, in the 1985-1988 period, the expansion was led primarily by residential construction and business investment in plant and equipment. The strength of the expansion was based on growth in personal income and corporate profits, healthy growth abroad, lower oil prices, stable interest and inflation rates, and an exchange rate that enhanced international competitiveness during the early part of the period.

Real business investment grew at an average annual rate of 15.5 per cent over the 1985-1988 period. Plants were modernized to meet international competition, and capacity increased to satisfy growing foreign and domestic demand.

Over 350,000 homes were built in Ontario in the 1985-1988 period. Strong growth in residential investment was supported by pent-up demand from the early 1980s, high levels of net interprovincial and international migration, and a decline in mortgage interest rates from the levels of the early 1980s. The high level of net migration to the province contributed to strong growth in the labour force. This, combined with reasonably stable inflation, resulted in moderate wage increases and rapidly growing employment.

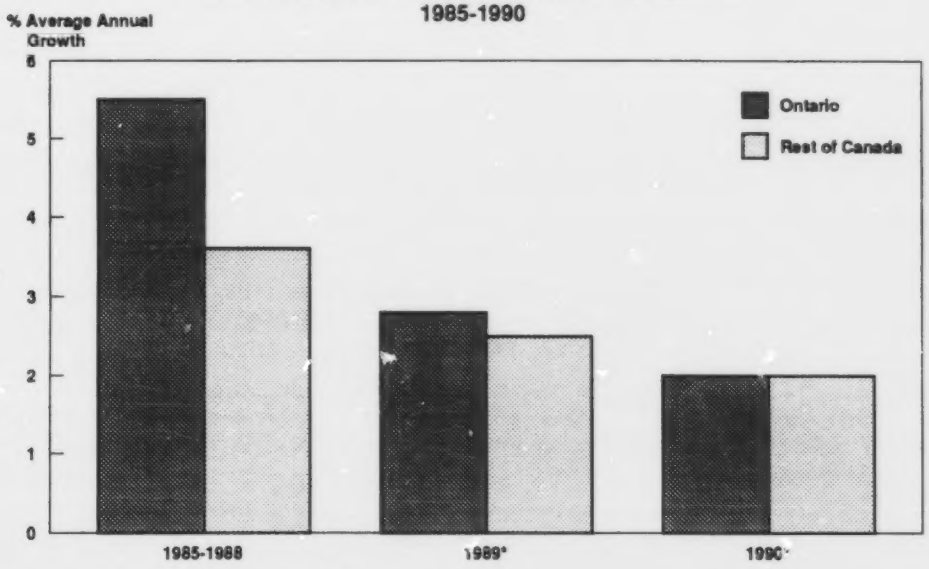
SOURCES OF REAL GROWTH IN ONTARIO
1985-1988



Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Throughout the expansion, growth in Ontario outpaced that in the rest of Canada. During 1989, however, growth across the country has become more balanced. Real output growth in Ontario will average 2.4 per cent per year in 1989-1990, roughly in line with growth in the rest of the country.

REAL GROWTH: ONTARIO VS. REST OF CANADA
1985-1990



* Estimate for 1989 and forecast for 1990.

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Key Assumptions: 1990

International and interprovincial exports account for almost half of the province's GDP. The growth prospects of Ontario's major trading partners therefore have a significant impact on Ontario's short-run economic performance. Financial markets and energy prices also have an important bearing on the outlook.

Ontario's Export Markets, 1988 — **Table 2**

	Share of Ontario GDP (%)	
Total International		31.9
United States	27.5	
European Community	1.5	
Japan	0.6	
Other	2.3	
Rest of Canada		15.0
Total		46.9

Source: Ontario Ministry of Treasury and Economics.

International Outlook

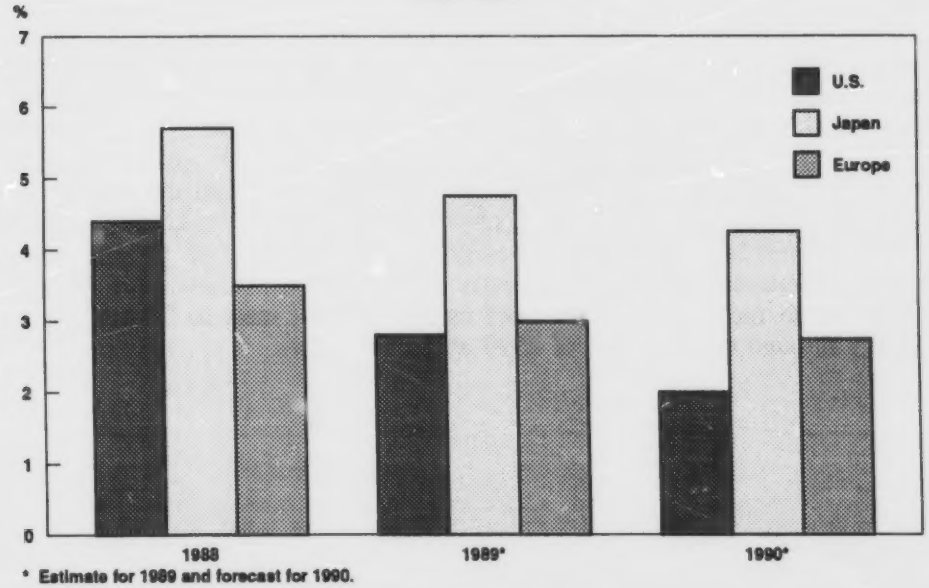
The rate of expansion of the United States economy is expected to decline modestly over the next year. Following an estimated gain of 2.8 per cent this year, United States real GDP is projected to expand by 2.0 per cent in 1990. While momentum will moderate from the pace exhibited since the start of 1988, the steady growth experienced so far this year and lower short-term interest rates have reduced fears of a recession in the near future.

Reduced buoyancy in net exports and business investment, which have led United States growth in recent years, will contribute to more subdued performance over the next year. Since the beginning of 1989, the United States dollar has risen by about ten to fifteen per cent against most major currencies. This rise, mirroring interest rate differentials and political uncertainties, will slow the growth of United States exports.

As a result of higher social security taxes and weaker growth in defence spending, fiscal policy in the United States will become somewhat more restrictive in 1990. Improvements in credit availability will help to offset the projected tightening of the federal government's budgetary stance. Due to the modest easing of Federal Reserve Board policy in mid-1989, short-term interest rates in the United States have declined by about one percentage point from their spring peaks. As borrowing costs have fallen, lower mortgage rates have provided support for residential construction.

Consumer price inflation in the United States rose in early 1989 to the highest level since the recession, reflecting pressures created by economic growth and higher costs for food and energy. Improved supply conditions for these products have eased inflation in recent months. The rate of increase of United States consumer prices is expected to drop to about 4.5 per cent in 1990 from about 5.0 per cent this year.

REAL GROWTH OF ONTARIO'S INTERNATIONAL TRADING PARTNERS
1988-1990



* Estimate for 1989 and forecast for 1990.

Source: OECD and Ontario Ministry of Treasury and Economics.

Economic growth in the other OECD countries will generally show more strength than in the United States in 1990. The OECD forecasts a 4.25 per cent pace of growth in Japan next year, down from 4.75 per cent in 1989. Growth in Western Europe will decelerate from 3.0 per cent this year to 2.75 per cent in 1990.

Rest of Canada

Growth in the rest of Canada in 1990 is expected to make a modest contribution to Ontario's export position, with strength in the Western provinces offsetting softness in Atlantic Canada.

Weakness in the fishing industry and reduced defence spending will slow growth in the Atlantic provinces in 1990. Offshore oil and gas development continues to be delayed. Increased coal production and the expansion of electric generating plants will have a modest positive effect.

In Quebec, which accounts for the largest proportion of Ontario's interprovincial exports, weaker consumer spending and moderation in investment are expected to lead to slower growth in 1990.

Manitoba and Saskatchewan are expected to record higher growth rates in 1990 as farm output continues to rebound following the 1988 drought. A recovery in oil and gas investment and new strength in forestry investment will contribute to stronger growth in Alberta.

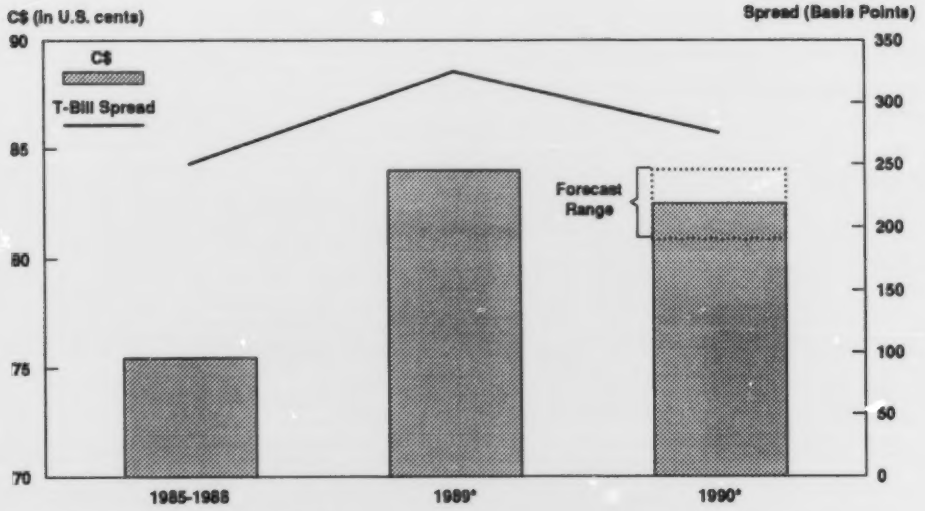
The forestry-dominated economy of British Columbia will be boosted by a recovery in the United States housing sector. Strong immigration will support rapid growth in the service sector in British Columbia this year and next.

Financial Markets

The Bank of Canada has increased the Canada-United States interest rate differential to levels unprecedented except during currency crises, triggering a further appreciation of the dollar. The short-term differential has averaged over 3.25 percentage points in 1989, sharply higher than its 1980-1988 average of 1.90 percentage points. In recent months the gap has exceeded four percentage points. Since early 1986, the Canadian dollar has risen from 69 cents U.S. to about 85 cents U.S., a 23 per cent increase.

The recent convergence of Canada-United States inflation rates and the rise in the Canadian dollar indicate that there is room for a narrowing of the Canada-United States short-term interest rate differential. The forecast assumes that the Bank of Canada will allow the interest rate differential to narrow in early 1990. The average value of the dollar is expected to fall to the U.S. 81 to 84 cent range. Interest rates in Canada are expected to fall modestly through the first half of 1990 as growth slows.

CANADA-U.S. EXCHANGE RATE AND 3-MONTH TREASURY BILL SPREAD
1985-1990



* Estimate for 1989 and forecast for 1990.

Source: Bank of Canada and Ontario Ministry of Treasury and Economics.

Energy Prices

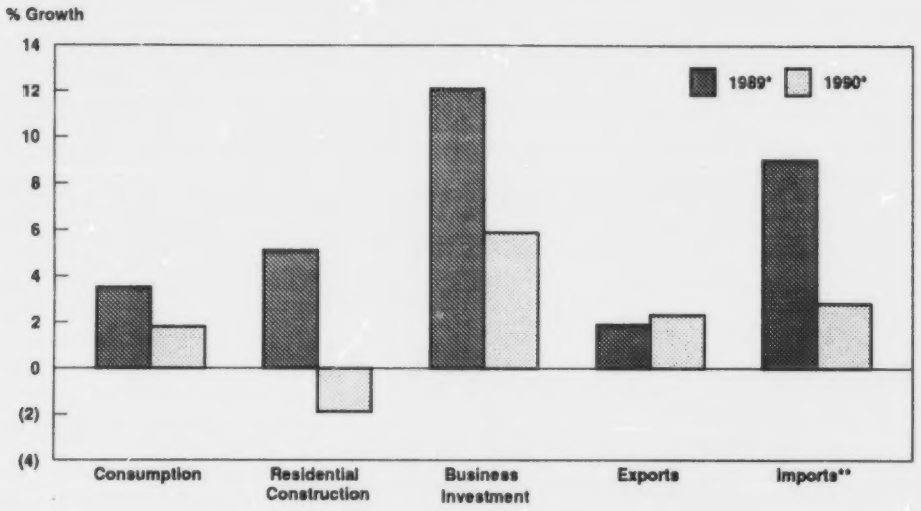
Ontario's oil and gas bill is expected to increase by eight per cent in 1989 and remain unchanged in 1990. During 1990, modest increases in the demand for refined petroleum products and natural gas are expected to be offset by small price decreases.

The direction of world oil prices in 1990 will be influenced by slower demand growth in the industrialized countries owing to a slowing global economy, a relatively stable political environment within OPEC, and the re-establishment of more normal supply arrangements in Alaska and the North Sea after this year's disruptions. These factors are expected to result in an average world oil price of $17.50 U.S. per barrel for 1990 compared to an estimated average for 1989 of $18.50 U.S.

The Outlook for 1990: More Moderate Growth and Inflation

Business investment will continue to grow more quickly than other components of demand in 1990. Growth in other sources of domestic demand, most notably consumer spending and housing, will continue to moderate.

SOURCES OF REAL GROWTH IN ONTARIO
1989 and 1990

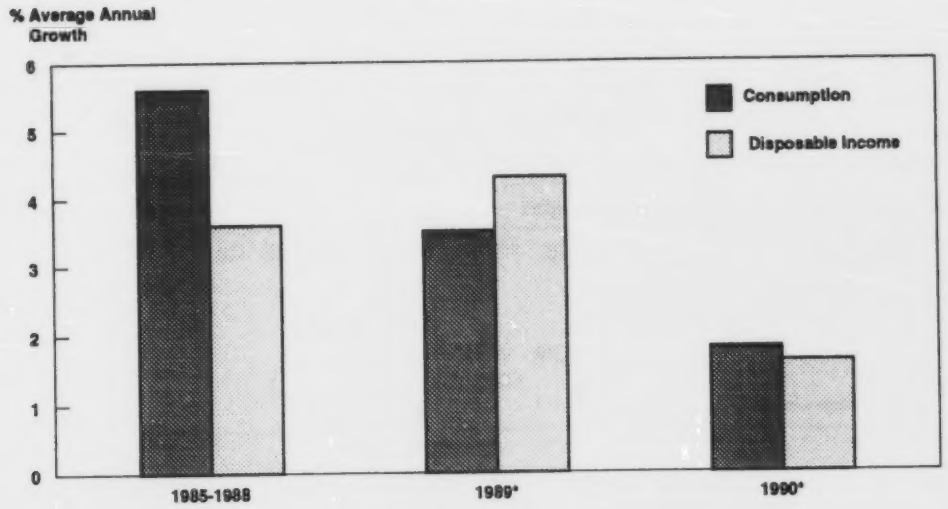


* Estimates for 1989 and forecast for 1990.
** Import growth has a negative effect on real growth.
Source: Ontario Ministry of Treasury and Economics.

Consumer Spending

Robust growth in personal income and a decline in the savings rate to a 16-year low fuelled strong growth in consumer spending over the 1985-1988 period. The moderation in growth of personal spending that has been evident in 1989 is expected to continue into 1990, reflecting a small upturn in the personal savings rate from its 1988 low, high consumer debt loads and slower income growth. Growth in real consumption will moderate from 3.5 per cent in 1989 to 1.8 per cent in 1990, down from 4.7 per cent in 1988. Over the 1985-1988 period, consumer spending growth outpaced the increase in personal disposable income, leading to a continued drop in the savings rate and an increase in debt loads. The savings rate rose from 12.2 per cent in 1988 to 12.6 per cent in 1989, reflecting consumer caution and the incentive of higher interest rates. The savings rate will edge down to 12.4 per cent in 1990.

REAL CONSUMPTION AND REAL PERSONAL DISPOSABLE INCOME
1985-1990



* Estimate for 1989 and forecast for 1990.

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

High interest rates and the high level of household debt relative to disposable income will restrain consumers from going further into debt to finance their purchases. The burden of household debt payments has grown rapidly since 1985. Between the first quarter of 1985 and the second quarter of 1989, total consumer and mortgage debt held by Canadians increased 88 per cent while disposable income rose only 35 per cent. Rising debt loads have made consumer behaviour more sensitive to interest rate movements.

Personal income growth is expected to moderate to 7.1 per cent in 1990 from 9.0 per cent in 1989 as job creation slows. Increases in investment income and in wages will partially offset the effects of smaller job gains.

In 1989 and 1990, spending on goods will grow more slowly than on services. Demand for consumer durables such as automobiles and major appliances will be the weakest component in consumer spending. The recent strength in housing-related durables spending is expected to diminish considerably as the pace of residential construction moderates.

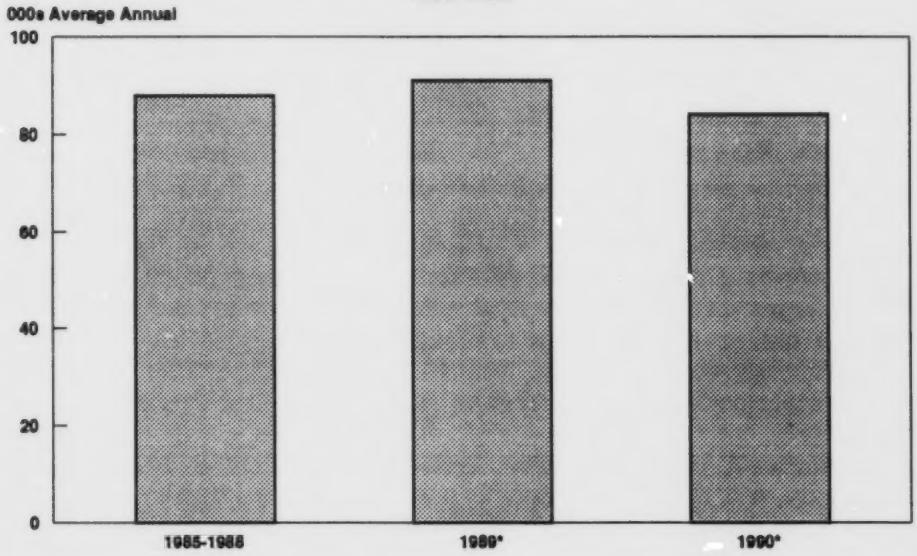
Housing
The housing market has been strong over the 1985-1988 period. Real residential investment growth averaged 11.7 per cent per year over the period. Housing starts totalled over 350,000. Several factors account for the recent strength in residential construction in Ontario:

- the favourable economic climate, with strong employment and income growth and declining interest rates in the early part of the period;
- pent-up demand from the recession; and
- the high level of net migration, especially interprovincial migration.

The current slowing in housing starts, sales and price increases reflects softening in the same underlying factors that initially fuelled strong residential construction:

- the economy is growing more slowly;
- much of the pent-up demand from the early 1980s has been met;
- affordability remains an issue due to high home prices and high short-term interest rates;
- in 1989 and 1990, housing completions are expected to outpace demand growth, adding significantly to the housing stock; and
- interprovincial migration is slowing, although international migration remains a strong source of demand for housing.

ONTARIO HOUSING STARTS
1985-1990



* Estimate for 1989 and forecast for 1990.

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

New home construction has continued at a healthy pace in 1989, reflecting strong pre-sales in late 1988 and early 1989. Housing starts are expected to total 91,000 in 1989. In 1990, a moderate pace of 84,000 starts is forecast.

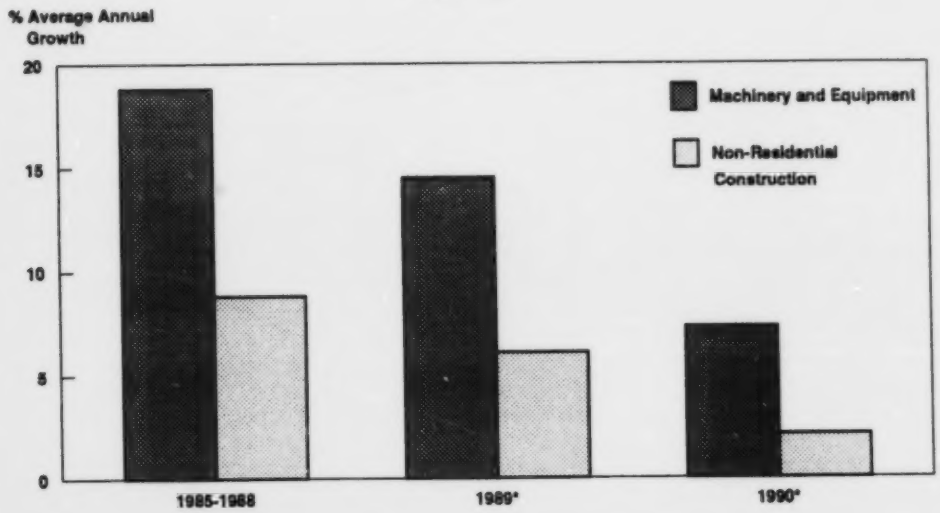
Real residential investment is expected to grow by 5.1 per cent this year and to contract by 1.9 per cent in 1990. Renovation activity, which accounts for about one-third of total residential investment, is forecast to grow moderately.

Resale activity is expected to remain soft through 1989 and to pick up during the first half of 1990 as interest rates ease.

Business Investment

Investment in plant and equipment was the most rapidly growing component of demand in 1988 and has remained so again this year. Further increases are expected next year, although at a slower pace. Strength in business investment is the result of healthy corporate profits, high rates of capacity utilization, continued sales growth, declining machinery and equipment prices, and the pressure of international competition.

REAL BUSINESS INVESTMENT
1985-1990



* Estimate for 1989 and forecast for 1990.

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Total real business investment is forecast to increase by 5.9 per cent in 1990. Real non-residential construction is expected to grow by 2.1 per cent in 1990, following an estimated 6.1 per cent rise this year. Real machinery and equipment investment is forecast to increase by 7.3 per cent in 1990, after an estimated 14.5 per cent increase in 1989.

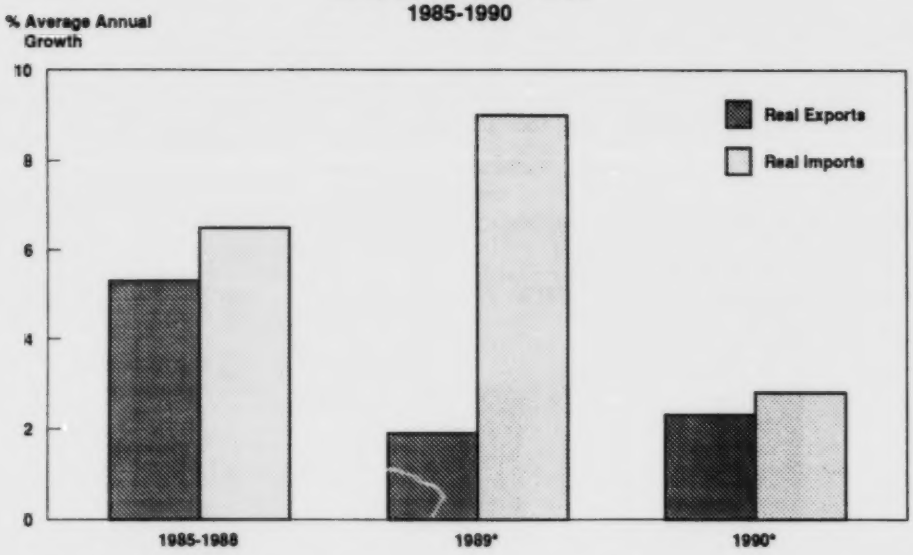
Following an estimated 4.8 per cent increase in 1989, corporate profits are expected to grow by 6.7 per cent in 1990. The appreciation of the Canadian dollar and moderating demand are restraining profit growth to well below the 14.4 per cent annual average recorded over the 1985-1988 period.

As a result of steady increases in industrial production, capacity utilization rates rose steadily from the end of the 1981-1982 recession until 1988. Smaller increases in domestic sales, weaker exports and new capacity resulting from the investment boom have caused capacity utilization rates to decline slightly in 1989. This will tend to moderate business investment in 1990.

External Trade

Imports of goods and services have been growing considerably faster than exports in 1989. Although import growth will slow in 1990, export growth will still lag slightly.

REAL EXTERNAL TRADE
1985-1990



*** Estimate for 1989 and forecast for 1990.**

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Export growth has slowed in 1989, primarily reflecting the higher Canadian dollar and slower growth in the United States. In real terms, Ontario exports are expected to grow by a modest 1.9 per cent in 1989, down from 8.0 per cent last year. In 1990, real export growth is expected to rise marginally to 2.3 per cent.

The 23 per cent appreciation of the Canadian dollar against the United States dollar since early 1986 has adversely affected the cost advantage enjoyed by Ontario's exports in the United States, where 86 per cent of Ontario's merchandise exports are sold. Within Canada, strength in Ontario's exports to Western Canada is expected to be offset by weaker growth in exports to Quebec and the Atlantic provinces.

Imports have increased significantly in 1989 in response to the continued strength in consumer spending and the surge in machinery and equipment investment, most of which is imported. The appreciation of the Canadian dollar has made foreign purchases cheaper. Real imports are expected to rise by 9.0 per cent in 1989, slowing to 2.8 per cent in 1990 as consumer spending and investment moderate.

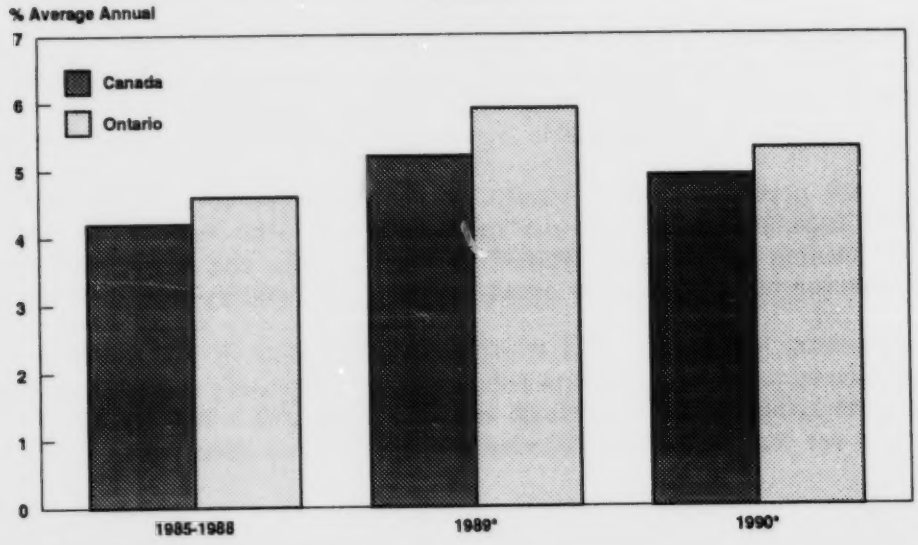
Inflation

Over the 1985 to 1988 period, Ontario's inflation rate as measured by the Consumer Price Index was relatively stable, ranging from a low of 4.1 per cent to a high of 5.1 per cent.

In 1989, inflation rose to an estimated 5.9 per cent in Ontario and to 5.2 per cent nationally. Several factors contributed to the rise, including higher wage settlements, higher oil prices and increases in indirect taxes. The appreciation of the Canadian dollar and less rapid economic growth have partially offset these factors.

Over the 1980-1986 period, the difference in inflation between Ontario and Canada averaged 0.1 percentage points, compared to 0.7 percentage points during 1987-1989. The gap between the Ontario and national inflation rates in recent years has been primarily the result of house price increases in the Toronto region. In 1990, the Ontario-Canada inflation gap is expected to narrow as house price increases in Southern Ontario moderate. Inflation in Canada and Ontario is expected to moderate in 1990 to 4.9 per cent and 5.3 per cent, respectively, in response to slower growth in demand and employment.

CANADA AND ONTARIO CPI INFLATION RATE
1985-1990



* Estimate for 1989 and forecast for 1990.

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

The Medium-Term Outlook for 1991-1993

In August the federal government announced details of its plans to introduce a 9 per cent Goods and Services Tax (GST) to take effect January 1, 1991. The economic effect of this tax, if it proceeds, will depend on the tax base and rate that are ultimately decided upon. If the tax proceeds as announced, its imposition will have significant effects on the Ontario economy in the medium term. For the purpose of this medium-term outlook, it is assumed that the GST will proceed as announced.

The Ontario Economy: 1991-1993 **Table 3**
(Annual Average)

Real Growth (%)	3.0
Inflation (%)	6.3
Job Creation (000s)	76
Unemployment Rate (%)	5.5

Source: Ontario Ministry of Treasury and Economics.

Over the 1991-1993 period, real output growth is expected to average 3.0 per cent per year. Business investment will continue to lead growth over this period. The CPI inflation rate is expected to average 6.3 per cent per year, 1.0 per cent above the expected 1988-1990 average. Job creation is expected to average 76,000 over the 1991-1993 period, down from an average of 111,000 in 1988-1990.

Annual growth in personal income in nominal terms is expected to average 8.8 per cent over the medium term, slightly above the 8.6 per cent average recorded during the 1988-1990 period. Inflation induced by the proposed GST is expected to offset slower job creation over the period.

Real consumer spending is forecast to increase at an average annual pace of 2.1 per cent, well below the 3.4 per cent rate recorded over the previous three years. Consumption growth will be restrained by slower employment growth and continuing high interest rates, as well as by the loss in real disposable income resulting from the proposed GST.

Despite slowing population growth, changes in the age profile of the population will tend to increase housing activity over the medium term. The baby-boom workforce is increasingly entering the age group typified by home purchase and renovation. As a result, residential investment is expected to expand slightly more quickly than the economy as a whole.

Real business investment is expected to remain the fastest growing source of demand in the Ontario economy, expanding at an annual rate of 7.5 per cent. This represents a slowing from the 11.3 per cent annual pace recorded over the previous three years.

Real net exports are forecast to decline marginally over the medium term, in response to continuing strong growth in machinery and equipment imports. Nevertheless, trade will be much less of a negative influence on the economy over the 1991-1993 period than it is projected to be over the 1988-1990 period.

Effects of the Proposed GST

If the federal Goods and Services Tax proceeds, it is expected to raise the consumer price inflation rate by an average of 1.6 per cent annually over the 1991-1993 period and to cause a loss in average real growth of 0.2 per cent annually. The GST is expected to reduce employment growth by an average of 18,000 jobs per year.

Workers are expected to attempt to recoup lost purchasing power by demanding larger wage increases. The Bank of Canada is expected to raise interest rates to attempt to counter this wage response.

The main effects of the introduction of this tax will be felt in 1991, with some adverse effects persisting in subsequent years.

First-Year Effects of the Proposed GST on the Ontario Economy	Table 4
	1991
Real GDP Growth (%)	(0.4)
CPI (%)	3.2
Job Creation (000s)	(23)
Unemployment Rate (%)	0.3

Source: Ontario Ministry of Treasury and Economics.

In 1991, the proposed GST will cause an initial direct rise in consumer prices. While this initial effect is expected to be close to the 2.25 per cent estimated by the Department of Finance, it will be followed by indirect effects that will raise inflation in Ontario by 3.2 percentage points in 1991.

Higher wage demands, if successful, will dampen the negative effect of the tax on real disposable income and thus cushion the first-year effects on output and employment. However, the inflation generated by this wage pressure will reduce growth in real income and employment in subsequent years.

Consumer spending will be particularly hard hit by the GST, as real personal income is eroded due to higher prices and lower employment growth. An expected rise in interest rates to counter GST-related inflation will further erode spending on consumer durables and housing.

The removal of the Manufacturers Sales Tax on business inputs will encourage investment by lowering the cost of capital. However, lower consumer spending will offset, at least in part, the stimulation of business investment arising from the GST.

The initial effect of the proposed GST on the international trade balance will be positive as sales taxes are removed from business inputs used in the production of exports and as imports face an increased relative tax burden. However, this effect is expected to be offset in 1992 and 1993 by added employment costs associated with higher prices and wages and by the initial appreciation of the Canadian dollar in response to higher interest rates.

Labour Force and Employment

The Outlook for 1990

In 1990, an estimated 71,000 new jobs will be created in Ontario. Employment growth will slow modestly but will remain high relative to that in the major industrialized economies. The unemployment rate will increase to 5.5 per cent, but will remain well below the national average of 8.1 per cent.

Ontario Labour Market Outlook **Table 5**

	1988	1989	1990
Labour Force (000s)	5,118	5,216	5,312
Change (%)	2.5	1.9	1.8
Employment (000s)	4,862	4,952	5,023
Change (%)	3.7	1.9	1.4
Job Creation (000s)	173	90	71
Unemployment (000s)	256	264	289
Unemployment Rate (%)	5.0	5.1	5.5
Participation Rate (%)	69.6	69.7	69.8

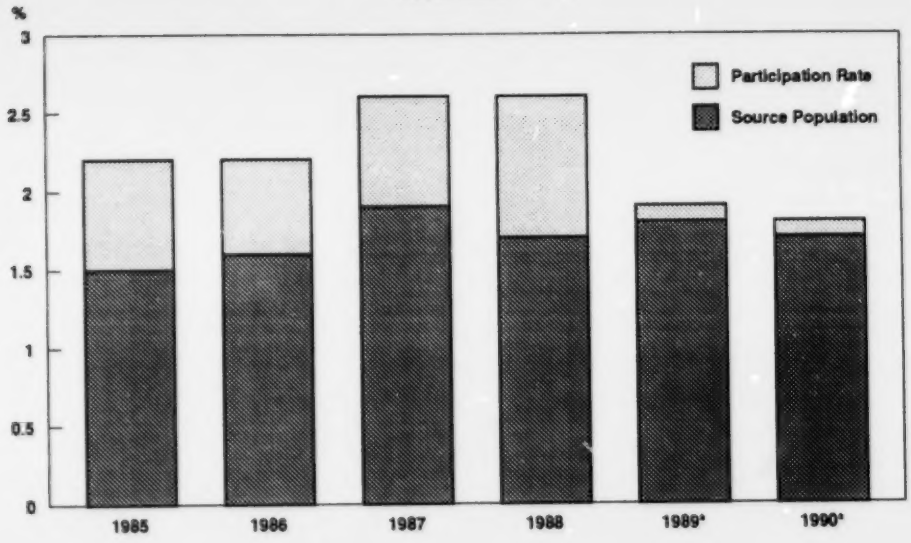
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

The Labour Force

Ontario's labour force has grown at an annual average rate of 2.3 per cent since 1985. This growth has been fuelled by high levels of net migration and continuing increases in the female participation rate. It is estimated that 79 per cent of working-age males and 61 per cent of working-age females participated in the labour force during 1989.

Ontario's labour force is expected to increase by 1.8 per cent in 1990. Growth in the working-age population will account for 94 per cent of the change, while participation rate increases will account for the remaining six per cent.

ONTARIO LABOUR FORCE GROWTH
1985-1990



* Estimate for 1989 and forecast for 1990.

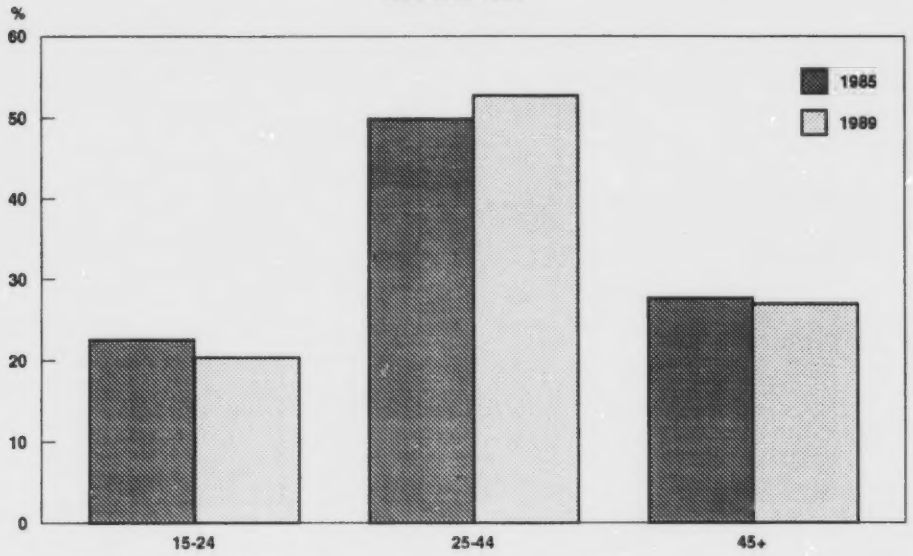
Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

The structure of the labour force has changed, reflecting the aging of the baby-boom generation and changes in the participation rates of certain demographic groups. The share of young workers aged 15 to 24 has fallen from 23 per cent of the labour force in 1985 to an estimated 20 per cent in 1989. The 25-44 age group, which has accounted for four-fifths of total growth since 1985, has increased its share from 50 to 53 per cent. The share of the labour force accounted for by workers aged 45 and over has declined marginally.

Women will account for an estimated 45 per cent of the labour force in 1989, up from 44 per cent in 1985. The increase in the share of women reflects rising participation rates. The number of two-income families has grown considerably, with the labour force participation of married women rising from 58 per cent in 1985 to an estimated 62 per cent in 1989. It is estimated that 64 per cent of women with pre-school children are now in the labour force in Ontario.

The average level of education of Ontario's labour force continues to rise, reflecting the higher educational levels of the baby-boom generation and the retirement of older workers. The proportion of the labour force with some post-secondary education has risen from 39 per cent in 1985 to an estimated 43 per cent in 1989.

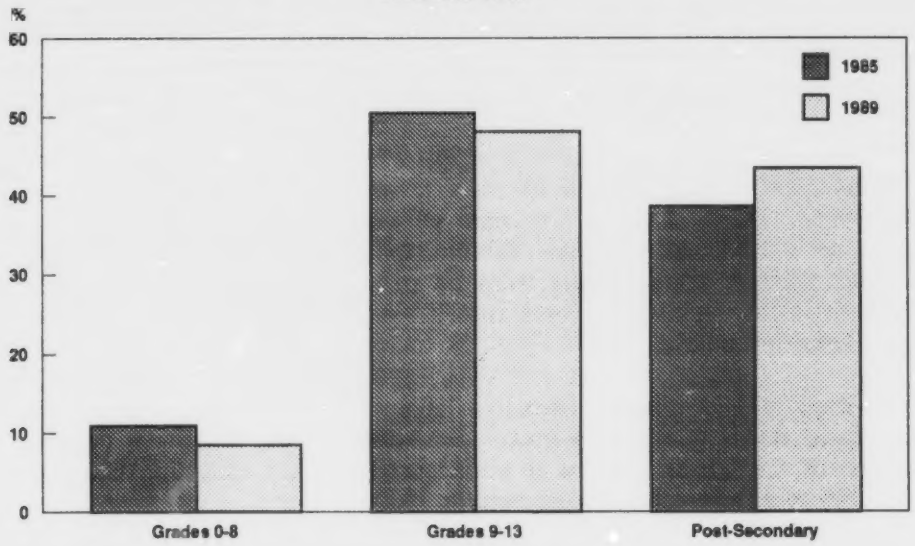
ONTARIO'S LABOUR FORCE BY AGE GROUP
1985 and 1989*



* January through September.

Source: Statistics Canada.

ONTARIO'S LABOUR FORCE BY EDUCATIONAL ATTAINMENT
1985 and 1989*



* January through September.

Source: Statistics Canada.

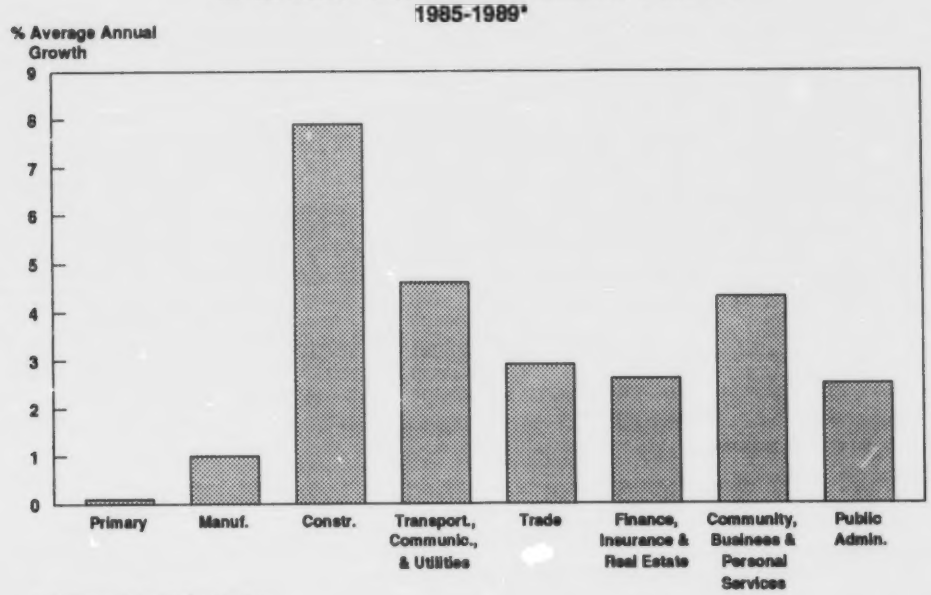
Employment

Ontario's Job Creation Record

Ontario's rate of employment growth has outpaced that of all other provinces over the 1985-1989 period, with an estimated average of 142,000 new jobs being created per year. Eighty-eight per cent were full-time positions and 12 per cent were part-time. Reflecting Ontario's tightening labour markets, the proportion of part-time employees who would prefer full-time employment has fallen from 22 per cent in 1985 to 15 per cent in 1989 to date.

Since 1985, employment in the service sector has increased by 20 per cent, almost double the 11 per cent growth in the goods-producing sector. As a result, the share of employment in the service sector has risen from 67.9 per cent in 1985 to an estimated 69.2 per cent in 1989.

EMPLOYMENT GROWTH BY INDUSTRY, ONTARIO
1985-1989*



* January through September.
Source: Statistics Canada.

The service sector has accounted for 79 per cent of all new jobs created in Ontario since 1985. The largest employment gain has been in community, business and personal services. These industries created 304,000 new jobs, representing more than 42 per cent of all jobs created in Ontario during this period.

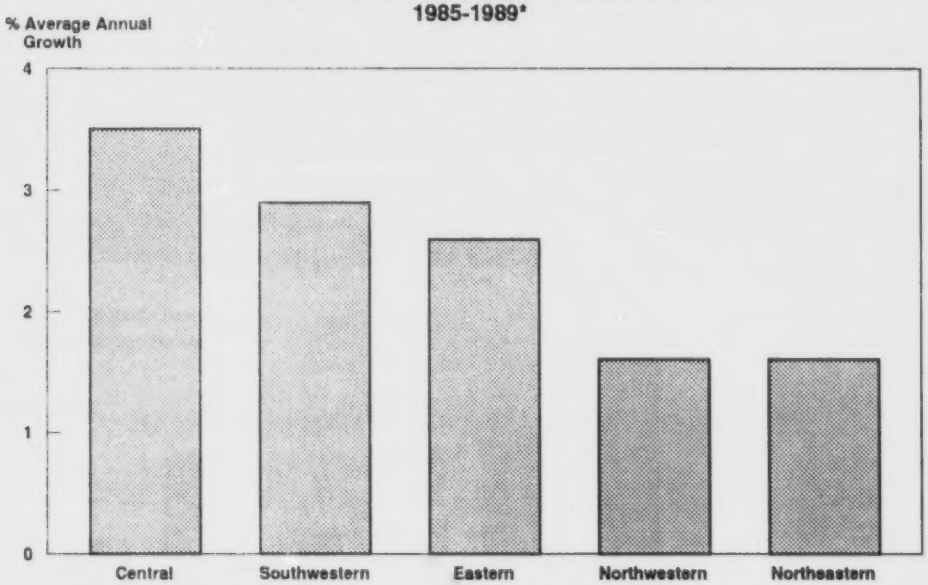
The number of jobs in manufacturing has increased by 49,000 over the 1985-1989 period to date. This represents an increase of five per cent, higher than in any of the major industrialized countries.

Of all the jobs created since 1985, 42 per cent have been in the managerial and professional category, and 92 per cent of those have been full-time positions. Over 60 per cent of the new managerial and professional jobs have been taken by women, reflecting their greater participation in the labour market, their increased education levels and the growth in the number of small businesses headed by women.

Regional Distribution of Job Creation

Employment growth has been distributed broadly among all regions of the province since 1985. Central and Southwestern Ontario have experienced the most rapid employment growth.

ONTARIO REGIONAL EMPLOYMENT GROWTH
1985-1989*



* January through September.

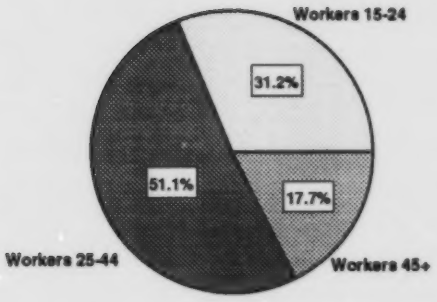
Source: Statistics Canada.

Unemployment

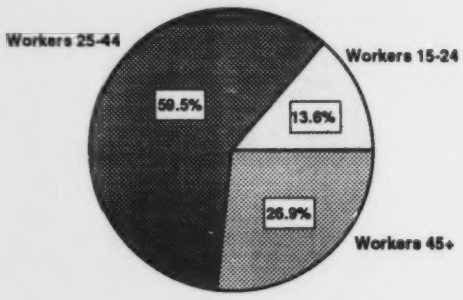
Age Profile of the Unemployed

While the unemployment rate of older workers (age 45 and over) is the lowest among demographic groups, older workers are over-represented among those who have been out of work for more than six months. In 1989 to date, older workers have accounted for 18 per cent of the unemployed, but have represented 27 per cent of long-term unemployment. The average duration of unemployment for older workers in Ontario has declined from 23.7 weeks in 1985 to 19.3 weeks in 1989 to date, while the duration of unemployment for youth has fallen from 12.5 weeks to 8.6 weeks. Given tighter labour markets, the concentration of long-duration unemployment among older workers suggests that their skills may be less portable than those of other demographic groups.

AGE PROFILE OF UNEMPLOYED
ONTARIO, 1989*



Share of Unemployment



Share of Long-Term Unemployment

* January through September.

Source: Statistics Canada.

Strong demand for young workers, combined with reduced supply, is reflected in lower youth unemployment. The number of unemployed youth has dropped from 140,000 in 1985 to 83,000 in 1989 to date. Youth now account for 31 per cent of all unemployed persons in Ontario, compared to 37 per cent in 1985.

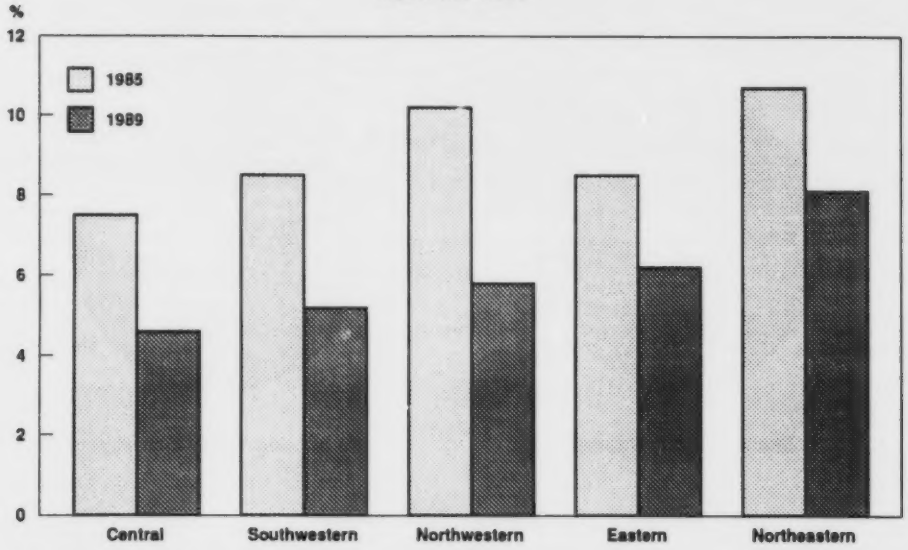
Layoffs

Major layoffs involving 50 or more workers have affected about 14,000 workers each year since 1985. Although the total number of employees affected has been stable over the period 1985 to August 1989, layoffs due to complete plant closures have increased slightly, indicating continued pressure on industries to adjust and restructure. Plant closures have occurred mostly in mature manufacturing industries and have affected older workers and long-service employees more severely than younger and more mobile workers. Laid-off older workers tend to experience longer periods of unemployment and greater difficulties finding re-employment.

Regional Dimension

Unemployment rates have fallen in all regions of Ontario. In Central Ontario, the unemployment rate is below five per cent. While unemployment rates in Northern and Eastern Ontario remain above the provincial average, they too have declined since 1985.

ONTARIO REGIONAL UNEMPLOYMENT RATES
1985 and 1989*



* January through September.

Source: Statistics Canada.

Skilled Labour Requirements

Many of the new and emerging jobs in the labour market require a broader range and higher level of skills than in the past. The federal government has estimated that 64 per cent of the new jobs created between 1986 and the year 2000 will require more than 12 years of education and training, compared to 44 per cent of current jobs.

The combined impacts of demographic, technological and economic change have resulted in shortages of skilled labour in certain occupations and market areas. For example, 50 per cent of respondents to a Canadian Federation of Independent Business survey cited shortages of qualified labour as a problem to their operations in 1988, compared to 30 per cent in 1985.

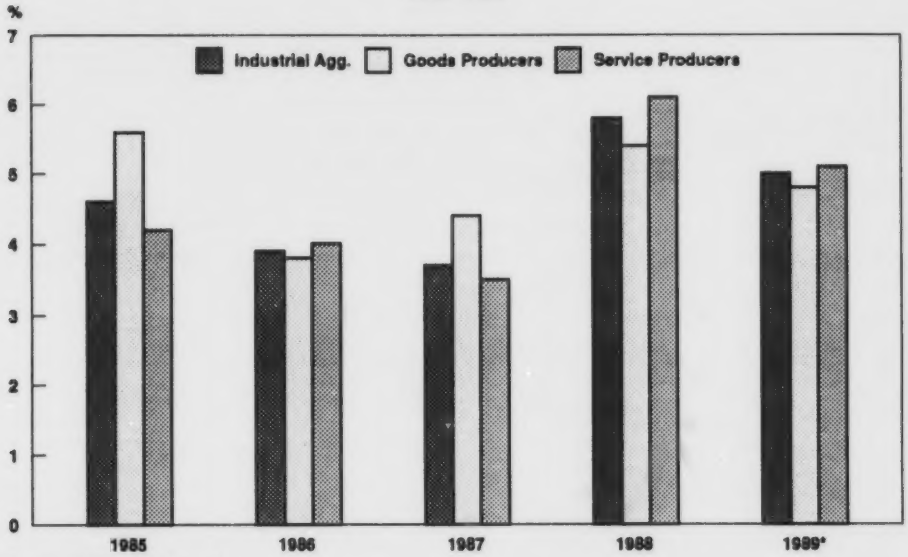
A recent study by the Ministry of Skills Development has identified 159 occupations as being in short supply in Ontario. Recruiting difficulties are most pronounced in such occupations as managers, engineers, engineering technicians, systems analysts, tool and die makers, and machinists. These shortages suggest a continuing need to upgrade and modernize the skills of the workforce.

Compensation Trends

Earnings

Average weekly earnings for paid workers in Ontario grew at an annual rate of 5.0 per cent in the first eight months of 1989. Between 1985 and 1989 to date, growth in average weekly earnings averaged 4.6 per cent per year.

ONTARIO AVERAGE WEEKLY EARNINGS INCREASES
1985-1989



* January through August.

Source: Statistics Canada.

For the second consecutive year, earnings growth in the service industries has outpaced that in the goods-producing industries. The trade sector and the transportation, communications and utilities sector have led the way, with increases of 6.1 and 5.5 per cent respectively.

Wage Settlements

In response to tight labour markets, the first two quarters of 1989 were characterized by intensified wage demands within large bargaining units. Ontario wage settlements covering 500 or more employees increased by 6.3 per cent, compared to 5.3 per cent in the same period in 1988. While this is significantly higher than the growth in average weekly earnings, wage settlement data cover only a small proportion of total employment. For example, agreements ratified in the first half of 1989 covered less than three per cent of Ontario's employed labour force.

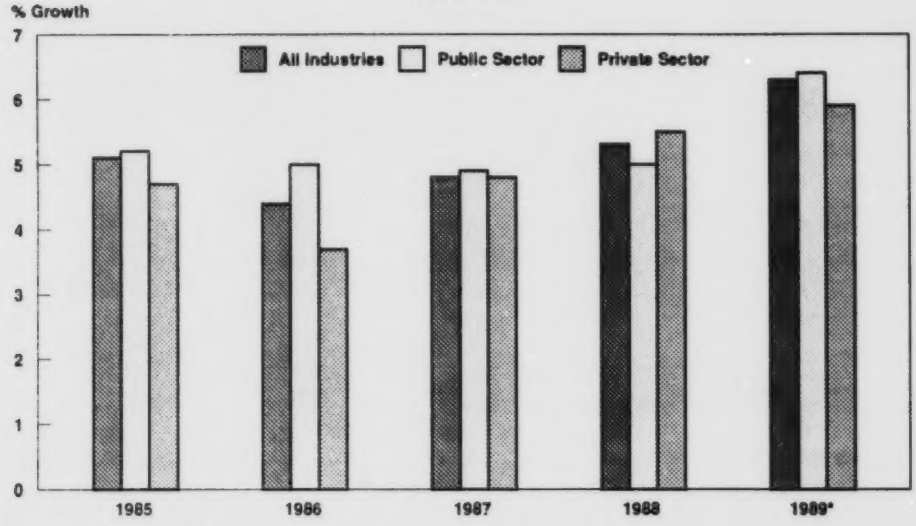
Wage settlements in Ontario continued to exceed Canadian settlements. Base wage rates in Ontario in the first half of 1989 increased by 6.3 per cent, compared to 4.8 per cent for Canada as a whole. The current Ontario-Canada differential is similar to patterns observed throughout most of this decade.

Collective bargaining activity in Ontario in 1989 is concentrated in the public sector, where increases averaged 6.4 per cent in the first half of the year compared with 5.9 per cent in the private sector. In 1988, public sector wage settlement increases averaged 5.0 per cent, compared with 5.5 per cent in the private sector.

In 1990, significant bargaining activity will occur in the private sector where major groups seeking to renew contracts include auto workers and construction unions. Wage pressures

may be moderated by employee concerns about job security in the face of international competition and by the expected slowdown in economic growth, particularly in construction.

ONTARIO WAGE SETTLEMENTS
(OVER 500 EMPLOYEES)
1985-1989



* January through June.

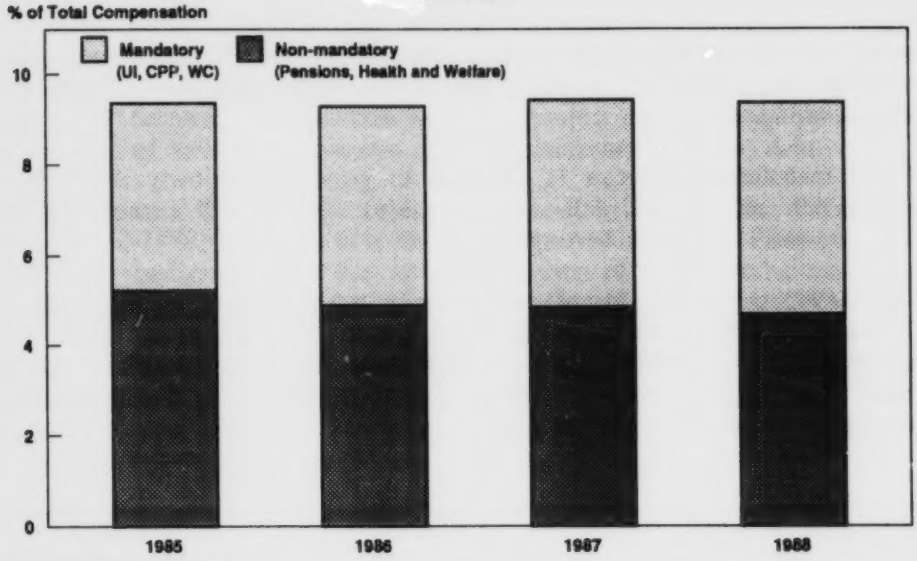
Source: Labour Canada and Statistics Canada.

Non-Wage Compensation

Non-wage compensation consists of mandatory and non-mandatory employer payments made for the benefit of employees. Mandatory payments include Canada Pension Plan (CPP), Unemployment Insurance (UI) and Workers' Compensation (WC) premiums. Non-mandatory payments are for the Ontario Health Insurance Plan (OHIP) and private health and pension plans. In 1988, non-wage compensation constituted 9.4 per cent of labour income. This proportion has not varied significantly since 1985.

Throughout the 1980s, the mandatory component of non-wage compensation has grown faster than non-mandatory payments. Mandatory items accounted for 50 per cent of total non-wage payments in 1988 compared to 33 per cent in 1980. Increases in WC and UI payments explain most of this increase. The mandatory component of non-wage compensation is likely to continue to grow as a result of federal proposals to increase UI premiums. The introduction of the Ontario Employer Health Tax will also increase mandatory payments but will be offset by a decline in non-mandatory payments due to the abolition of OHIP premiums.

MANDATORY AND NON-MANDATORY COMPONENTS OF NON-WAGE COMPENSATION IN ONTARIO 1985-1988



Source: Statistics Canada.

The Sectoral Outlook

Overview

Most sectors of the economy will expand throughout the 1990-1993 period, but more slowly than in the 1985-1989 period. This reflects slower economic growth for the economy as a whole.

In 1990, the manufacturing sector is expected to grow more slowly than other sectors, while construction activity will fall. Service sector growth will exceed the average in 1990.

For the 1991-1993 period, the manufacturing sector is expected to rebound, based on high growth in the transportation equipment and investment goods industries. Little real growth is forecast for resource-based industries. Consumer products industries will grow less rapidly than other manufacturing, as will the service sector, partly due to the introduction of the federal Goods and Services Tax.

Sectoral Outlook **Table 6**

	1988		Real Output Growth		
	Employment	Share of Real Output	1989	1990	1991-93
	(000s)	%	%	%	%
Primary Sector	170	4.1	3.7	2.4	2.1
Manufacturing	1,028	26.8	1.7	1.0	3.2
Resource-Based	141	3.5	1.8	(0.1)	0.3
Transportation Equipment	173	5.0	0.2	1.7	5.8
Investment Goods	175	5.4	3.9	2.2	4.1
Intermediate Products	276	7.2	0.9	0.9	3.1
Consumer Products	263	5.7	2.1	0.3	1.7
Construction	291	7.1	5.4	(0.6)	3.1
Utilities	55	2.4	4.1	3.8	3.0
Service Sector	3,318	59.6	2.9	2.6	2.9
Total	4,862	100.0	2.8	2.0	3.0

Source: Statistics Canada and Ontario Ministry of Treasury and Economics.

Agriculture

During the 1980s the Ontario agricultural economy has been strained by a combination of over-capitalization, disruptive foreign agricultural policies, fluctuating livestock prices and low grain prices. The nearly 30 per cent of the industry that operates under supply management has fared well, but other sectors have suffered. Uncertainty in those sectors without the security of cost-related product pricing has led to an emphasis on reducing liabilities. Dairy farmers, who produce within a supply management system, have been increasing the size of their operations and assuming increased levels of debt.

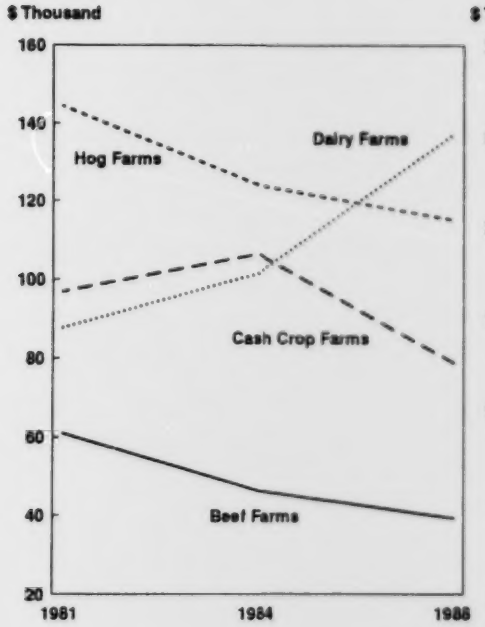
Real agricultural output in 1989 is expected to increase by 3.0 per cent from the drought-depressed levels of 1988, primarily as a result of improved weather. Farm incomes are not expected to show similar increases due to a combination of rising production expenses and lower crop prices in response to increased world supplies of grains and oilseeds.

Over the next four years real agricultural output is expected to grow at an average annual rate of 1.8 per cent. Rising production costs and declining prices for **cereals and oilseeds** will tend to discourage production increases. **Red meat** production is expected to increase in 1990 and 1991 in response to lower feed costs and rising hog prices.

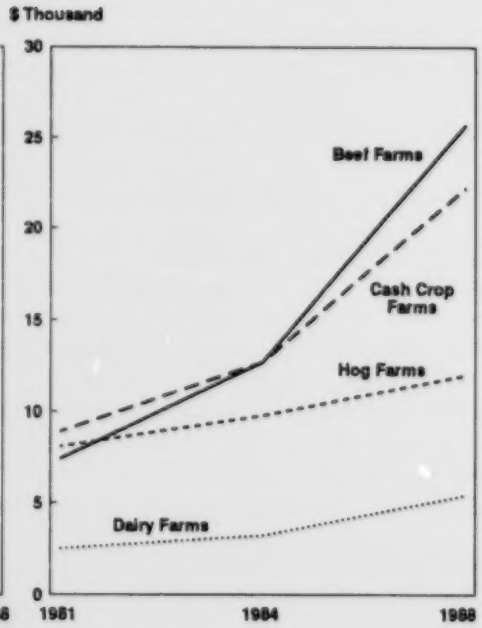
The joint federal and provincial Grape Acreage Reduction Program has been largely responsible for a 20 per cent drop in grape production in 1989. This reduction is expected to offset the increased production of other **fruits and vegetables** resulting from improved growing conditions.

The 1989 target for the Ontario **tobacco** harvest has been set at 153 million pounds, up 14 per cent from the 1988 harvest. The 1989 production level is seen as a short-term production peak to provide for increased exports and some stock rebuilding. The current three-year accord with manufacturers provides for smaller crops in 1990 and 1991.

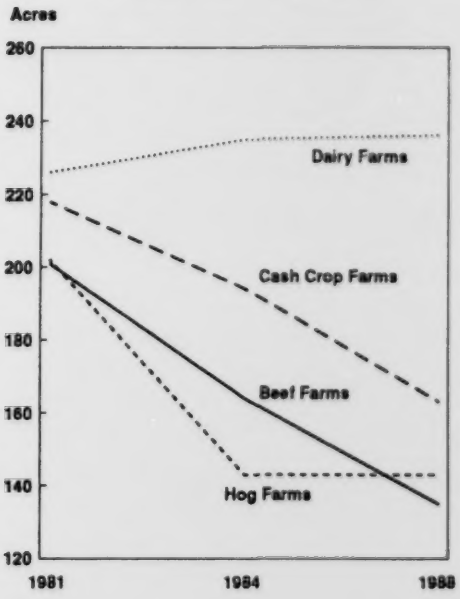
AVERAGE FARM LIABILITIES



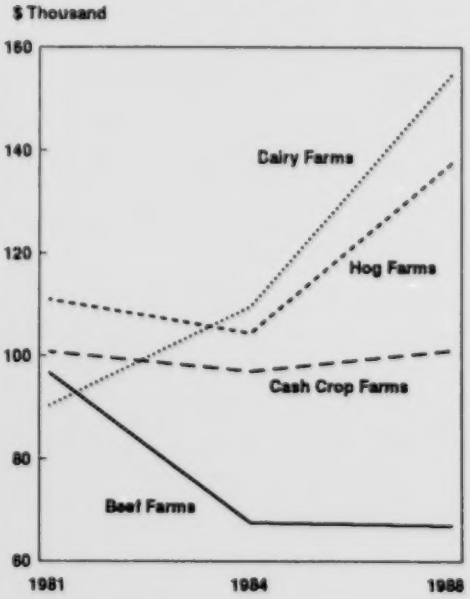
AVERAGE NET OFF-FARM INCOME



AVERAGE ACRES FARMED



AVERAGE FARM SALES



Source: Farm Credit Corporation.

Resource and Resource-Based Industries

This group includes logging, forest products, mining and primary metals.

Ontario's **forest industries** — wood, pulp, paper and allied industries — employed about 84,000 in 1989, an increase of about three per cent over the previous year. Forest industry employment is particularly important in Northwestern Ontario, where it accounts for some 67 per cent of the region's total employment in primary and manufacturing activities.

Activity in the **wood products** sector is driven by new residential construction and renovation. Ontario housing starts, although down from a record level of 105,000 in 1987, are still relatively strong. They are expected to reach 91,000 this year, and 84,000 next year. The slower pace of new home construction in 1990 will cause a softening in wood products sales. Modest growth is expected to resume during 1991-1993.

Within the **pulp and paper** sector, pulp producers continue to enjoy strong demand and rising prices, but newsprint demand and prices have slackened. A large increase in North American newsprint capacity is beginning to come onstream. With the slower rate of growth in the United States and Canadian economies, this excess capacity is likely to depress operating rates and prices for the next few years.

Mining and primary metal industries employ 90,000 in Ontario. Nearly half of this employment is concentrated in Northeastern Ontario, where it represents almost 54 per cent of the region's total employment in primary and manufacturing activities.

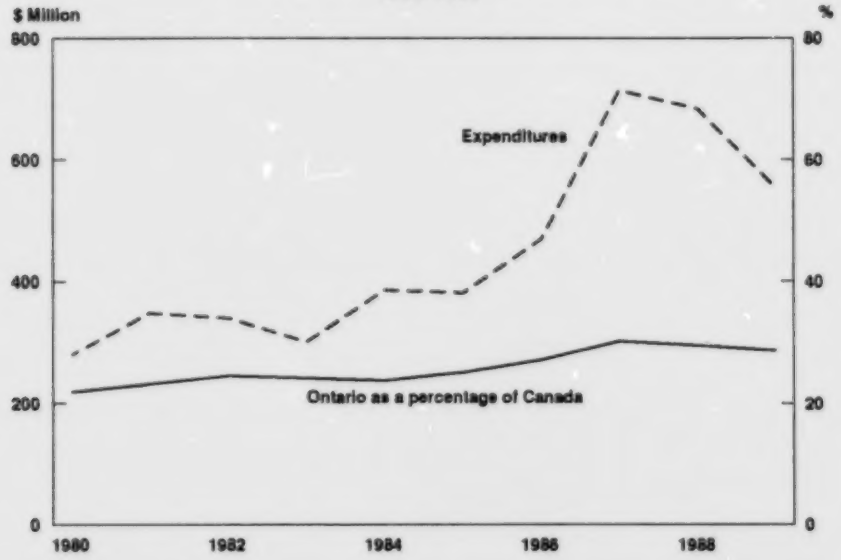
Spending intentions for exploration and mine-site development in Ontario for 1989 total $554 million, down from $683 million in 1988 and a peak of $714 million in 1987. This reflects less favourable federal tax treatment of flow-through financing of exploration and the completion of a number of new mine development projects.

The outlook for Ontario's leading minerals remains generally favourable. Although the price of gold has slumped to about $360 U.S. per ounce, many mines are realizing higher prices because of forward sales. Based on 1989 production plans, Ontario gold output is expected to increase by 28 per cent. Some new mines are also expected to come into production in 1990.

The recent high prices for base metals — nickel, copper and zinc — are not expected to last as the global economy enters a period of slower growth, and some additional world mine capacity comes on stream. However, prices are still expected to ensure reasonable profit levels for Ontario's low- to medium-cost mining operations. More moderate and stable metal prices may also reduce the threat of substitution by cheaper materials and will benefit metals' longer-term prospects.

While the spot market price for uranium has fallen by one-third over the past year, most of Ontario's production is still being sold at higher prices under long-term contracts with Ontario Hydro and other utilities. Producers are reducing costs to compete with low-cost mines in Saskatchewan.

ONTARIO EXPLORATION AND MINE DEVELOPMENT EXPENDITURES 1980-1989



Source: Statistics Canada.

Ontario's **steel** production continued its upward trend in 1989, buoyed by demand from the automotive sector and a modest recovery in the energy sector. Demand is expected to level off in 1990.

Ontario's steel industry accounts for about 78 per cent of Canadian steel production and employs about 45,000. Twenty per cent of Ontario's $7.9 billion steel production is exported to the United States.

Rationalization and modernization are continuing as the outlook for steel consumption remains relatively flat. The removal of United States restraints on steel imports, expected in 1992, will expand Ontario steel producers' market opportunities. Ontario mills currently have a small advantage due to lower labour and material costs compared to their United States counterparts.

Transportation Equipment

Motor vehicle assembly and parts account for over two-thirds of transportation equipment output and employment. Aerospace, bus, and railway equipment manufacturing comprise the remainder of the sector. This sector contributes 19 per cent of Ontario's manufacturing output.

The performance of Ontario **motor vehicle and parts** manufacturers is dependent on market conditions in the United States. Ontario manufacturers export approximately 90 per cent of production, with the United States receiving 98 per cent of these exports. Because the Ontario industry is a fully integrated part of the North American industry under the Auto Pact, it is much more export-oriented than its Japanese or West German counterparts.

Despite an estimated seven per cent decline in 1989 North American sales, Ontario motor vehicle output is expected to grow slightly due to continuing increases in Ontario production capacity and declines in North American imports.

North American sales are forecast to decline a further three per cent in 1990, reflecting slower economic growth. Nevertheless, Ontario's auto industry is expected to show an increase in output as new plants increase production to full capacity.

In the medium term, Ontario motor vehicle output is expected to exhibit strong growth. This reflects a gradual recovery in United States sales following 1990 and Ontario's expanding share of North American assembly capacity.

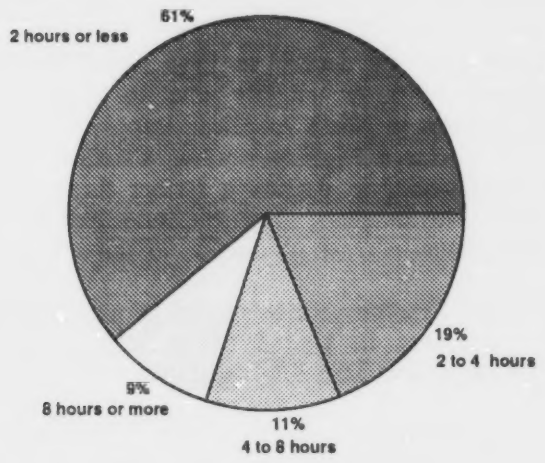
Ontario's motor vehicle parts industry, which is nearly three times as large as the assembly industry in output and employment, increased output significantly in 1988 to meet demand from increased North American vehicle production. In 1989, motor vehicle parts output is forecast to decline marginally, reflecting lower North American production levels induced by declining sales.

In the medium term, the Ontario parts industry is expected to grow strongly, reflecting the recovery in North American vehicle sales after 1990 and the shift to higher value-added vehicles. The sector will benefit from proximity to a growing assembly market especially as a result of recent investments in assembly capacity in Canada.

Shifts in production technologies and systems will continue to cause restructuring in the auto parts industry with associated plant closings, openings or expansions. The success of individual firms will depend on their ability to meet assemblers' price, quality and delivery requirements relative to their competitors.

The continued implementation of the just-in-time production system — in which parts are delivered to assembly plants when they are required, eliminating the need for warehousing — will be a key factor in determining the future performance of the Ontario parts sector. Ontario parts plants are well positioned to benefit from just-in-time production. Forty-five per cent of North American assembly capability is within two hours' delivery time by truck, and 75 per cent is within eight hours. Most of the Ontario parts industry already specializes in just-in-time components and competes primarily with plants in the Great Lakes region rather than with low-wage jurisdictions such as Mexico.

ONTARIO AUTO PARTS PRODUCTION
BY JUST-IN-TIME DELIVERY CATEGORY
1986



Source: Roger Miller (Université du Québec), Statistics Canada and Ontario Ministry of Treasury and Economics.

In the **rubber** industry, closures of major tire plants reduced output in 1988. Recent investments in plant and technology such as at Goodyear's new Napanee plant are expected to improve the outlook for output and employment.

The **aerospace** segment of the transportation equipment sector is experiencing robust growth and is operating at close to full capacity. Ontario manufacturers of aircraft and components are benefitting from increasing global demand due to the growth in commuter airline traffic and fleet replacement by major airlines. A growing order backlog indicates that strong activity in this segment is assured over the forecast period.

Investment Goods

Investment goods include industrial electronics, machinery, scientific equipment and office furniture. In 1988, this sector accounted for 20 per cent of Ontario manufacturing output. Nearly half of this sector's production is destined for the world market. Investment goods comprise 12 per cent of Ontario's total exports to the United States, 26 per cent to Western Europe and 32 per cent to other countries.

As a result of higher levels of business investment, global rationalization and automation in the manufacturing sector, the investment goods industries experienced strong growth in 1988 and 1989. As North American business investment in machinery and equipment is expected to slow, growth will moderate over the medium term.

Growth in the **industrial electrical and electronics** sector — which includes telephones, computers, electric transformers, and similar goods — is being driven by business investment and modernization plans to improve productivity. Since 1985, the value of Ontario shipments in this sector has increased by 26 per cent in constant dollars, while Ontario's manufacturing shipments as a whole have increased by 13 per cent.

The communications equipment sector is internationally competitive, and reduced tariffs are not expected to affect the performance of the industry adversely. Stronger growth is expected in the markets of the newly industrialized countries as the North American market becomes saturated with digital technology. Softening in the telecommunications market and a higher exchange rate will lead to reduced but healthy growth over the forecast period.

The **machinery** industry has rebounded due to restructuring and rationalization of the manufacturing sector. Increased output in the machinery sector in 1988 and 1989 has reflected the healthy levels of business investment in plant and equipment. Strength in the resource-based industries has improved the outlook for manufacturers of mining and construction machinery. Overall growth in the industry will slow as business investment moderates over the medium term.

The **scientific equipment industry** supplies a broad range of products in computer-based control, automation, monitoring and supervisory systems used in industry. The majority of Canadian-owned instrumentation companies are competitive in export markets within narrow product and technology niches because of their relatively small size, low overhead costs, shorter delivery times and flexibility. Over the medium term, growth is expected to be comparable to that of the manufacturing sector as a whole.

Exports to the United States have played an important role in Ontario's **office furniture** industry. In general, the industry is competitive with United States producers in terms of design, quality and service. Until recently, higher domestic production costs have been offset by favourable exchange rate movements. Growth is forecast to exceed the manufacturing average to 1993.

Intermediate Products

Intermediate products include non-metallic minerals, fabricated metals, chemicals, plastics, commercial printing and petroleum refining. The sector is oriented toward domestic business activity, although in some industries trade is significant with northern states. Intermediate products constitute 27 per cent of manufacturing production in Ontario.

In recent years, intermediate products industries have benefitted from the continued expansion of the economy. Excluding petroleum refining, which has been affected by sales of fuel-efficient automobiles, real shipments in this sector have increased 19 per cent since 1985, significantly faster than the 13 per cent for manufacturing as a whole. Recent growth in profits, industry modernization and export-oriented restructuring provide the basis for continued growth in intermediate products industries averaging 3.1 per cent annually through 1993.

Recent rapid growth in **non-metallic minerals** (primarily cement and concrete) is expected to moderate over the 1990-1993 period as growth in residential construction slows. The cement industry is successful in exporting to the United States due to market accessibility, insufficient capacity in border states and access to limestone, water transportation and low-cost electricity. Elimination of United States tariffs on concrete products over the next five years will allow Ontario producers to take advantage of substantial economies of scale and cost savings in this capital-intensive industry.

The strong growth in shipments of **fabricated metal** products has slowed since 1987. Output has been supported by the buoyant construction and automotive sectors and substantial increases in machinery and equipment investment. Over the forecast period, annual growth will exceed three per cent. Growth in industry segments dependent on housing construction will moderate over the forecast period as the growth of residential construction declines.

The **chemical** industry is benefitting from global restructuring, increased business investment and rising demand. The appreciation of the Canadian dollar over the past year has exerted competitive pressure on some firms. Following a period of restructuring through 1990, growth is expected to resume over the longer term.

Over the medium term, growth in **plastics** output will slow. In addition to a return to more normal demand growth, technological innovations in packaging and recycling will continue to affect the market for plastic packaging.

Since 1985, **commercial printing** has been growing at 5.9 per cent annually. In 1987 Ontario exported 31 per cent of shipments and accounted for 53 per cent of Canadian exports. The outlook is for slower growth over the forecast period as business activity moderates.

Demand for **petroleum** products will grow modestly reflecting the impact of conservation, efficiency improvements and substitution of alternative fuels.

Consumer Products Industries

This group includes food processing, beverages, textiles and apparel, consumer-related printing and publishing, consumer appliance industries, and household furniture.

Consumer spending on these goods has increased by less than consumer spending on other items such as recreation, education, transportation, automobiles and housing. As a result, the share of consumer spending on consumer products has declined from 42 per cent in 1970 to 35 per cent in 1987. In addition, domestic producers are slowly losing market share to importers.

The Ontario **food processing** sector is expected to continue to grow slowly along with population growth in its primary markets in Ontario and the rest of Canada. Stiff import competition is limiting growth in the fruit and vegetable processing industry. Specialty food processors are showing rapid growth as many firms have successfully developed markets for high value-added products such as convenience foods.

The **beverage** industry will show only slight growth marked by the quickly expanding soft drink industry and the slower growing beer industry. Continued market softening is expected for the spirits and wine industries.

Following significant restructuring in recent years, production in the **tobacco** manufacturing industry is forecast to decline modestly over the medium term.

Growth in the Ontario **textile and clothing** industries is expected to slow and is dependent on the industries' success in a narrow range of products geared mainly to North American markets. The textile industry faces slower demand from the home furnishings market in the medium term. Competition from imported textiles may become stiffer if the federal International Trade Tribunal reduces tariffs on foreign products. If enacted, lower tariffs on textiles would benefit the clothing industry, which nevertheless is facing slower consumer demand and strong competition from low-wage countries in the medium term.

In contrast to most consumer products industries, **consumer printing and publishing** has been growing quickly. As the tariff protection that printing and publishing has enjoyed will lessen in the future, companies are undertaking major restructuring actions, including rationalization and mergers. In the medium term, growth is expected to slow but to remain above the average for consumer products. Demand for reading materials will continue to grow, and Canadian printing industries are finding niche markets in Canada and the United States that large-scale firms in the United States cannot effectively serve.

The housing boom, increased personal income and the novelty of microwave ovens have generated a mini-boom in **consumer appliance** products in the last several years. The industry is expected to enter a period of much slower growth as housing construction levels off and demand for consumer appliances becomes saturated. Moreover, Canada will have to compete with United States plants which in many cases are more specialized and have larger production scales.

After several years of growth based largely on the housing boom, the **household furniture** industry will likely slow down starting in 1990. Canadian household furniture firms are less automated than their United States counterparts. Some are more competitive in market segments where design rather than price is the customer's main concern.

Construction

The construction industry has been one of the strongest performers during the current economic expansion. The industry has benefitted from the strong demand for housing and from commercial and industrial projects.

During 1989 activity has begun to moderate. Growth in business investment and housing has been weaker than in 1988. Commercial, institutional and industrial starts have declined. There has been a slowdown in major new capital investment announcements to offset the completion of large automotive, nuclear, and commercial projects. In 1990, real output in the construction sector will decline slightly.

Over the medium term, performance in the construction sector is expected to match that of the economy as a whole. Construction activity will benefit from the anticipated return to stronger economic growth and from a stabilization in housing starts.

Utilities

The utilities sector will be restrained by the general slowdown in housing construction but will grow in line with the overall economy in 1990. Over the medium term, efforts directed at energy conservation and environmental protection will have a moderating influence on this sector.

Investment by Ontario Hydro, which dominates activities in the electricity sector, will decrease in 1990 and 1991 and will increase marginally in 1992. This investment pattern reflects the completion of the four-unit Darlington nuclear generating station and major transmission projects in Southwestern and Eastern Ontario. The decline in investment in the electricity sector may be offset by higher investment in natural gas pipeline and compression facilities to accommodate increasing gas exports to the United States via Ontario.

Service Sector

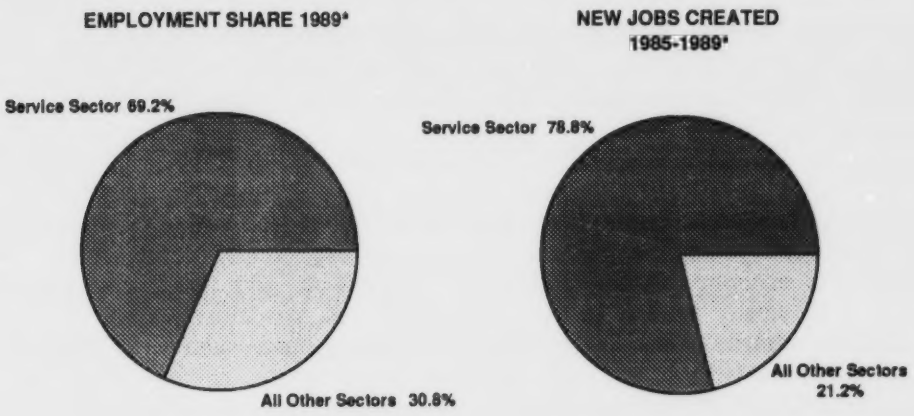
The service sector accounts for approximately 60 per cent of total provincial output and nearly 70 per cent of employment. Service activities include transportation and communications; wholesale and retail trade; banking and insurance; health care; education; services to business management; and public administration.

In recent years, growth of service sector output has been roughly comparable to the growth of output in the goods-producing sector. However, service sector industries are less cyclical than goods-producing industries. As the economy continues to experience decelerating growth in 1990, service sector output growth is expected to be stronger than output growth for the goods-producing industries. Over the 1991-1993 period, service sector output growth is expected to lag behind growth in the goods sector of the economy, as consumer spending on services is expected to be adversely affected if the GST is enacted as proposed.

Over the medium term, the share of overall employment attributable to the service sector is expected to continue growing, although not as rapidly as during the past decade. Factors constraining more rapid employment growth in services include the imposition of the proposed GST and the difficulty in recruiting entry-level workers.

The effect of the proposed GST is not expected to be uniform across the service sector. Sectors which have been most lightly burdened by the manufacturer's sales tax on their purchased inputs and which will now bear the GST will be hardest hit, along with their suppliers. These would include the tourism and hospitality industries; amusement and recreational services; accounting, law, and investment counselling services to individuals; and personal services such as hairstyling, cleaning, and household services.

SERVICE SECTOR SHARE OF EMPLOYMENT AND NEW JOBS
1985-1989



* January through September.

Source: Statistics Canada.

Financial Services

The financial services sector includes the banking, trust, brokerage and insurance industries. Activity has been strong over the past four years, with employment levels rising by more than 25,000. This sector has encountered a number of challenges, including the October 1987 stock market crash; growing debt levels, particularly among consumers and Third World countries; and the need to restructure and change strategies in response to increased competitive pressures and regulatory reform. Over the forecast period, performance in financial services is expected to be strengthened by the introduction of new financial products and innovations and continued productivity growth. Real output growth in financial services is expected to exceed that of the overall service sector.

The financial services sector will be largely exempt from the proposed GST. Financial services such as lending money, issuing life insurance, or underwriting equities will not be subject to the tax. However, the inputs that financial institutions use in providing exempt services will be taxable, and financial institutions will not be able to claim offsetting input tax credits since they will be considered to be the final consumers of these inputs. This will increase costs and may weaken the international competitive position of many Canadian financial institutions.

Business Services

The business services sector includes computer, accounting, advertising, personnel, architectural, engineering, legal and management consulting activities. It is an important producer of intermediate input services which are used in the further production of goods and services. Nearly nine per cent of employment in the service sector is attributable to the business services component. Since 1985, the business services sector has enjoyed the fastest employment growth rate among all sub-groupings within the service sector.

The business services sector is a significant contributor to productivity growth in the Ontario economy, providing expertise to those who seek to integrate new knowledge into the production process. During the 1980s, firms in the goods sector have increasingly drawn on specialized business services.

Over the forecast period, output and employment performance in business services are expected to benefit from strong growth in computer, engineering, and consulting services, from growing demand for specialized business services, and from the development of new export opportunities.

Tourism

Ontario's tourism sector accounts directly for about 4.2 per cent of provincial employment. Over the past three years, the tourism industry has experienced solid growth, benefitting from a vigorous economy, strong employment expansion, and rising disposable incomes. Ontario has seen steady growth in international visitors, particularly from Europe and the Pacific Rim, and traffic from the United States market has stabilized. Ontario's tourist attractions, accommodations and natural settings contribute to its ability to compete effectively in increasingly sophisticated domestic and international travel markets.

Recent indications of reduced growth in tourism spending have made the imposition of the federal GST a serious concern for the industry. The proposed GST will lower real disposable incomes over the medium term, resulting in lower consumer spending on discretionary items such as tourism. The tax will also reduce the cost-competitiveness of the Ontario industry in comparison with foreign destinations. Tourism and related businesses can be expected to respond to lower revenues by reducing employment and foregoing investment in facilities and new services.

Ontario's Position in a Changing World Economy

The International Context

The past decade has witnessed a strengthening in the ties between Ontario's economic performance and developments at the global level. The reality of expanding global interdependence is reflected in the growth of Ontario's trade and investment flows. These have extensive implications for Ontario's economic performance.

Some of the international forces affecting the province include:

- the impressive economic success of Japan and the Newly Industrialized Economies (NIEs), increasing the competitive pressure on key Ontario industries;
- rapid shifts in the development and diffusion rates of new technology;
- the globalization of world financial markets, reducing national flexibility in setting monetary policy; and
- the increasingly pivotal role of large multinational corporations in coordinating production, research spending and intra-industry trade.

The Canada-United States Free Trade Agreement provides a new framework for trade between the two countries, including the phase-out of tariffs over the next decade. The agreement provides for further negotiations to develop a new set of trade rules governing anti-dumping and subsidy-countervail actions. It also establishes a Select Auto Panel to study prospects for the North American motor vehicle industry. While evidence of the agreement's overall effect is not yet available, United States actions in 1989 against Canadian producers of pork and steel rail confirm that the agreement has not substantially increased Canada's security of access to the United States market.

At the multilateral level, negotiations at the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) are scheduled for completion at the end of 1990. They seek to liberalize world trade further and to extend international trade rules to agriculture, services and the protection of intellectual property such as copyright and patents.

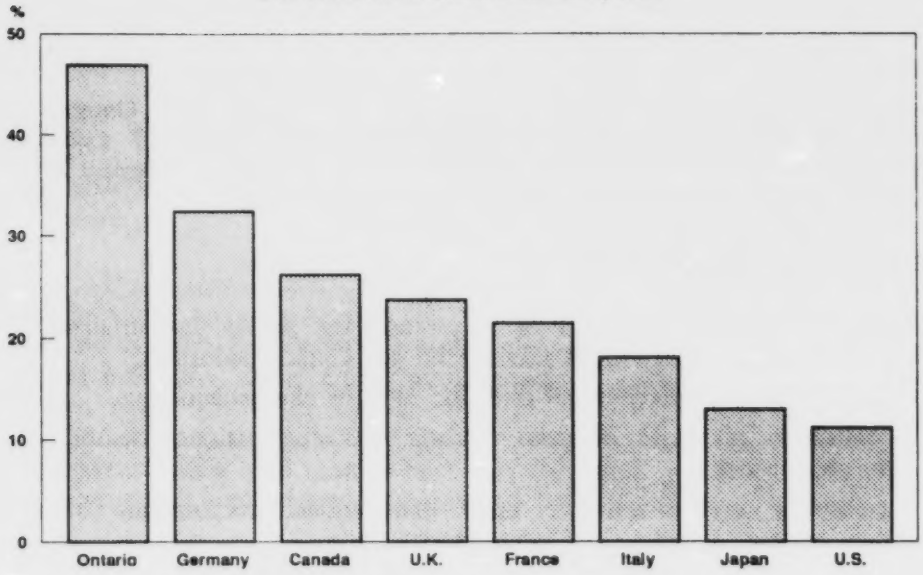
The European Community is moving towards completion of a single internal market. By 1992, most of the existing barriers to the movement of goods, persons and capital between the twelve member states are expected to be phased out, creating a single market of 320 million people.

Ontario's International Trade

Ontario's exports as a share of GDP surpass those of each of the Group of Seven countries. At the same time, Ontario is less dependent on international commerce than some European Community nations such as Belgium.

In 1988, 32 per cent of Ontario's exports went to other provinces while 68 per cent were international exports. Over the decade, Ontario's international exports have grown faster than its interprovincial exports.

EXPORTS AS A SHARE OF GDP, 1988



Source: OECD, Statistics Canada and Ontario Ministry of Treasury and Economics.

Ontario exporters continue to rely heavily on the United States market, which purchased 86 per cent of the province's international exports in 1988. Since the early 1980s, the share of Ontario's exports directed along north-south lines has increased. The United States is also the principal supplier of Ontario imports, accounting for three-quarters of Ontario's imports in 1988.

MAJOR EXPORT MARKETS, 1988

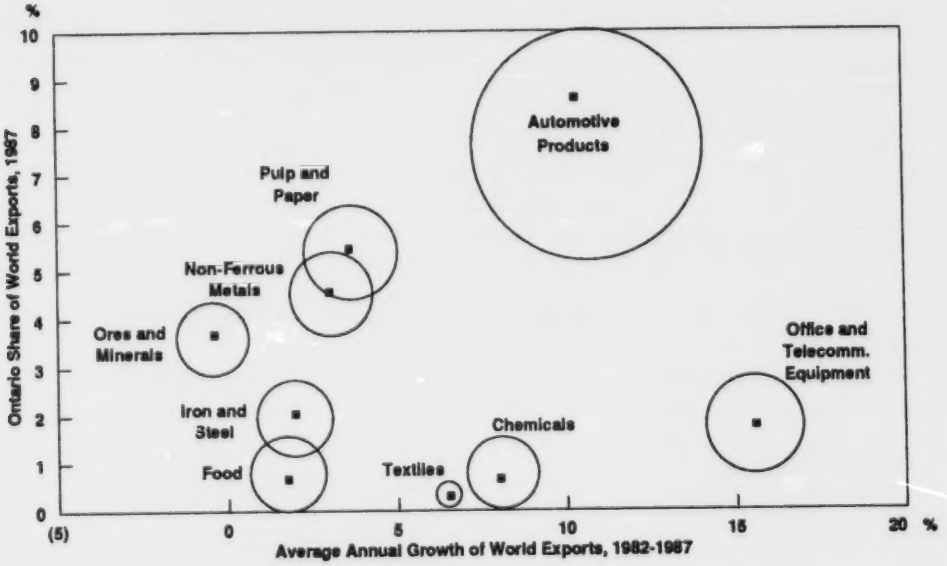
Source: OECD Monthly Statistics of Foreign Trade.

The automotive sector, which accounted for almost half of exports from the province in 1988, dominates Ontario's trade in manufactured goods. Ontario's strength in this sector has coincided with a remarkable expansion of world trade in motor vehicles. International shipments of cars and trucks have grown by an average of ten per cent per year since 1982, and Ontario holds a significant share of the global market.

Ontario's leading exports of high-technology goods are office equipment and telecommunications equipment. World trade in these two areas has grown even more rapidly than in autos, expanding at an average annual rate of more than 15 per cent since the early 1980s. However, Ontario's share of the world market for these products is comparatively small.

Ontario's world market share is much larger for resource-based exports such as iron and steel, ores and other metals and mineral products. World demand for these commodities has grown slowly since 1982. Ontario producers continue to face strong competition from mineral and metals producers in the developing countries. Excess capacity remains in the steel industry in both developed and developing countries.

ONTARIO'S SHARE OF WORLD EXPORTS, 1987



Note: Size of circle is proportional to Ontario exports.
Source: GATT and Statistics Canada.

International Comparisons

Recently the World Economic Forum and the IMEDE, two Swiss-based organizations, released a report on the economic potential and competitive status of a number of industrialized countries.[1] Canada, along with Japan, Switzerland, and the United States,

1 World Economic Forum and the International Management Development Institute, *The World Competitiveness Report*, 1989.

was ranked among the most attractive countries as a location for economic activity. Compared to an earlier survey, Canada showed improvements in the macroeconomic and business environment and in industrial efficiency, while continuing to face challenges in its ability to innovate and to adapt to international trends. While the report does not rank individual provinces, the results for Canada reflect favourably on Ontario as the leading province in manufacturing and finance.

Ontario's attractiveness as a location for both existing business and new enterprises is affected by a number of economic factors, including:

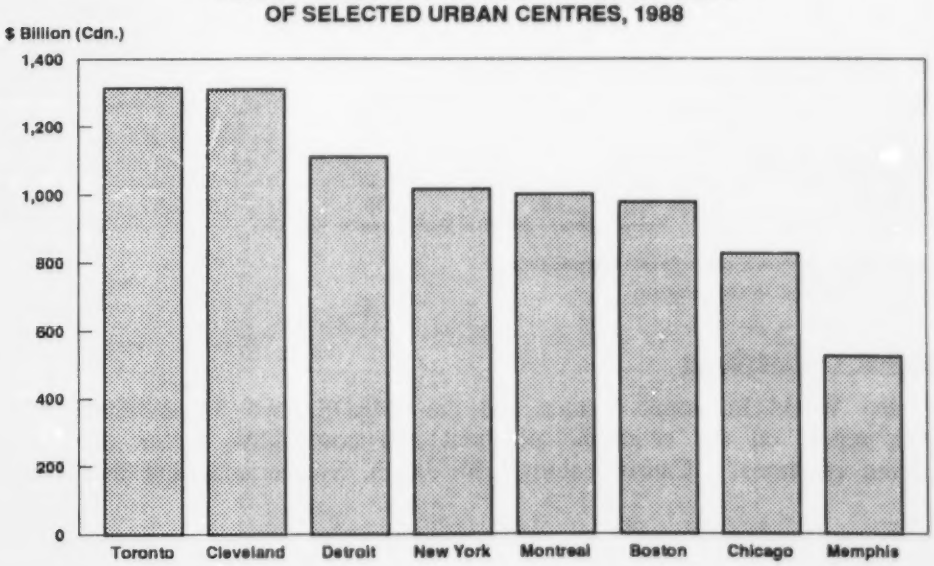
- location in the North American market;
- labour compensation;
- capital investment and productivity;
- industrial R and D effort; and
- energy costs.

Location in the North American Market

Ontario manufacturers have a strong locational advantage within the Canadian market. The Ontario economy itself is the largest in Canada and is centrally located. The advantage is even stronger for investment goods and intermediate products manufacturers, who have access to a concentrated client base: 53 per cent of Canadian manufacturing activity is in Ontario.

Ontario is also favourably positioned with respect to the United States market, with ready access to both the United States midwest and the United States Atlantic seaboard. Toronto's one-day trucking access to consumer markets in North America exceeds that for any major city. As well, the Oshawa-to-Windsor corridor ranks favourably as a just-in-time location for industries such as auto parts.

TOTAL HOUSEHOLD INCOME WITHIN 400 MILES OF SELECTED URBAN CENTRES, 1988

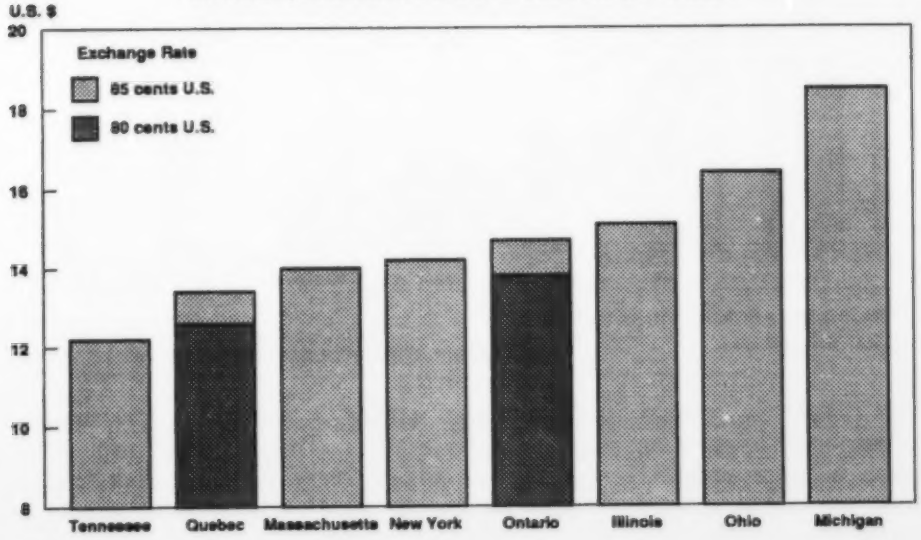


Source: Compusearch Market and Social Research Limited and Ontario Ministry of Treasury and Economics.

Labour Compensation

During 1989 the exchange rate has been close to 85 cents U.S. At this level, Ontario's hourly compensation for production workers remains comparable to that in most of the Great Lakes states, but is higher than in states such as New York and Massachusetts. Ontario would rank third in labour costs, behind Tennessee and Quebec, if the exchange rate were to return to the 80 cent level.

HOURLY MANUFACTURING COMPENSATION
ONTARIO, QUEBEC AND SELECTED STATES, 1988



Source: Statistics Canada and U.S. Bureau of Labor Statistics.

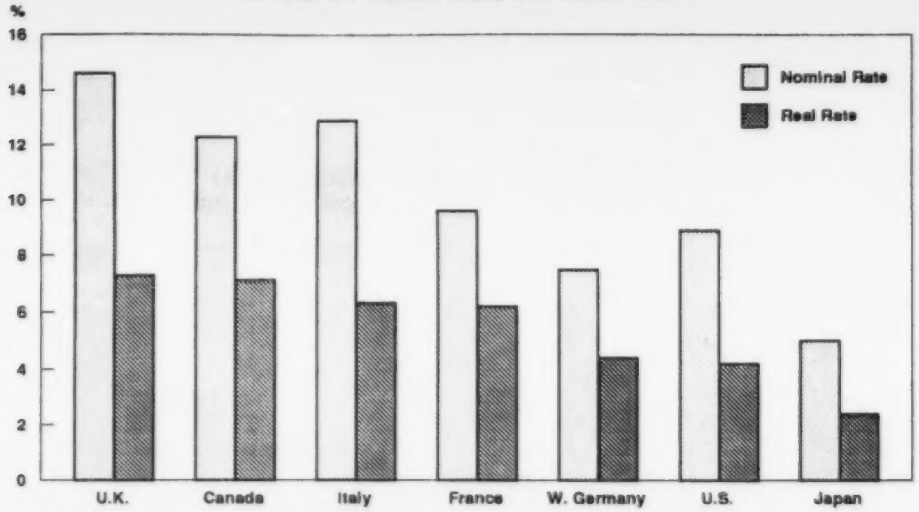
Labour compensation includes both wages and benefits. In the United States a major benefit is health care, with employers' average medical care premiums per worker now at $3,117 U.S. or 13.6 per cent of payroll compared to $1,453 U.S. or 7.9 per cent of payroll in 1984. By comparison, Ontario's Employer Health Tax will range from 0.98 to 1.95 per cent of payroll.

Capital Investment and Productivity

Ontario manufacturers face a disadvantage compared to their United States competitors because interest rates, especially short-term rates, are higher in Canada. These rates discourage capital investment.

Canada's short-term real interest rates are among the highest of the G-7 countries. As a result, borrowing has been discouraged and domestic demand has been dampened. The differential between Canadian and United States short-term real rates has risen over the past year to about three percentage points.

SHORT-TERM INTEREST RATES IN THE G-7 COUNTRIES, OCTOBER 1989

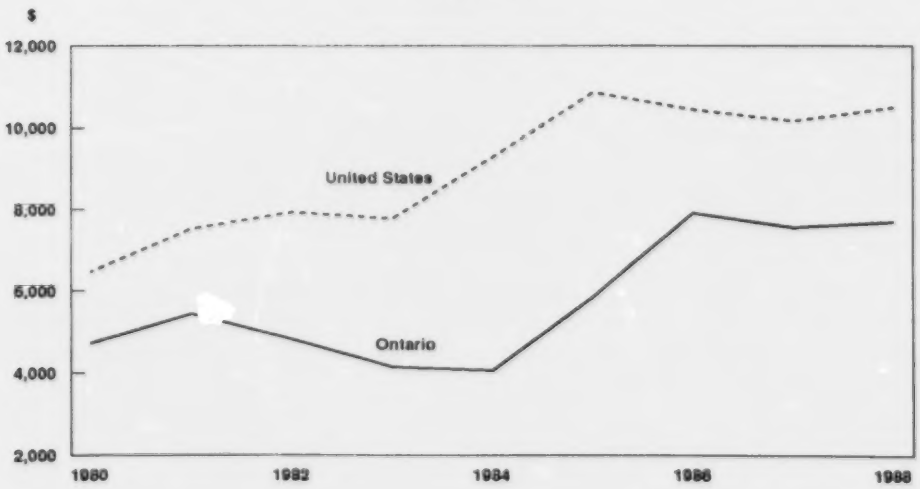


Note: Real Rate = Nominal Rate - Inflation Rate.

Source: The Economist.

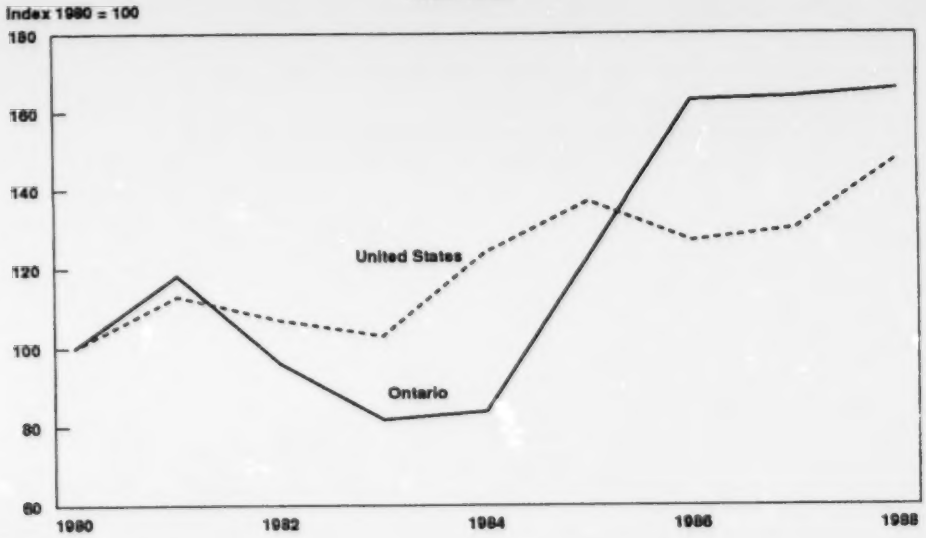
During the 1980s new capital investment per worker in Ontario, expressed in common currency, has been lower than in the United States. This reflects lower United States interest rates, a more severe cutback in the United States manufacturing labour force in basic industries, and investment related to increasing United States defence production. Despite these disadvantages, the rate of growth in Ontario's manufacturing investment has outpaced that of the United States since the mid-1980s.

CAPITAL EXPENDITURES PER WORKER IN MANUFACTURING 1980-1988



Source: Statistics Canada and Wharton Econometric Forecasting Associates.

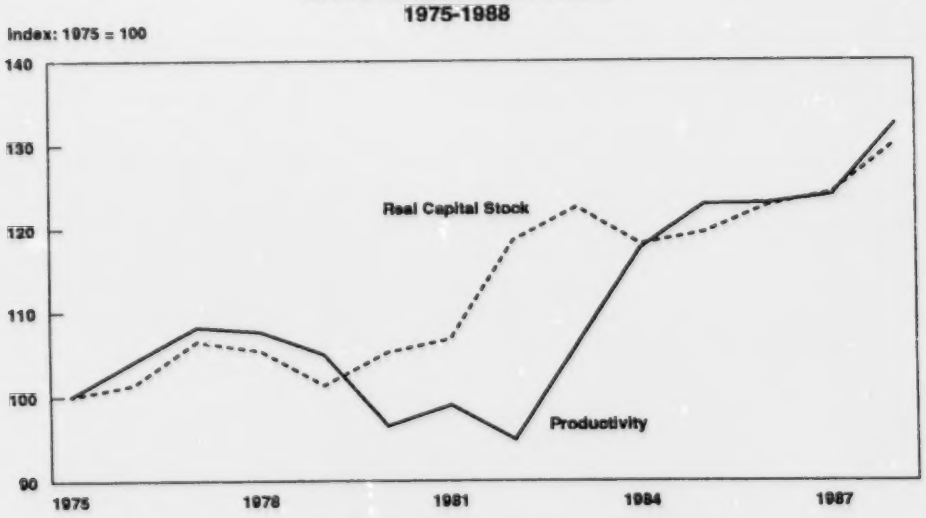
MANUFACTURING INVESTMENT
1980-1988



Source: Statistics Canada and U.S. Department of Commerce.

While labour productivity depends on many factors, including skills and technical innovation, productivity improvement is closely linked to increased capital investment. Between 1975 and 1988, the real capital stock per worker in Ontario manufacturing rose 29 per cent, closely tracking the 31 per cent increase in labour productivity.

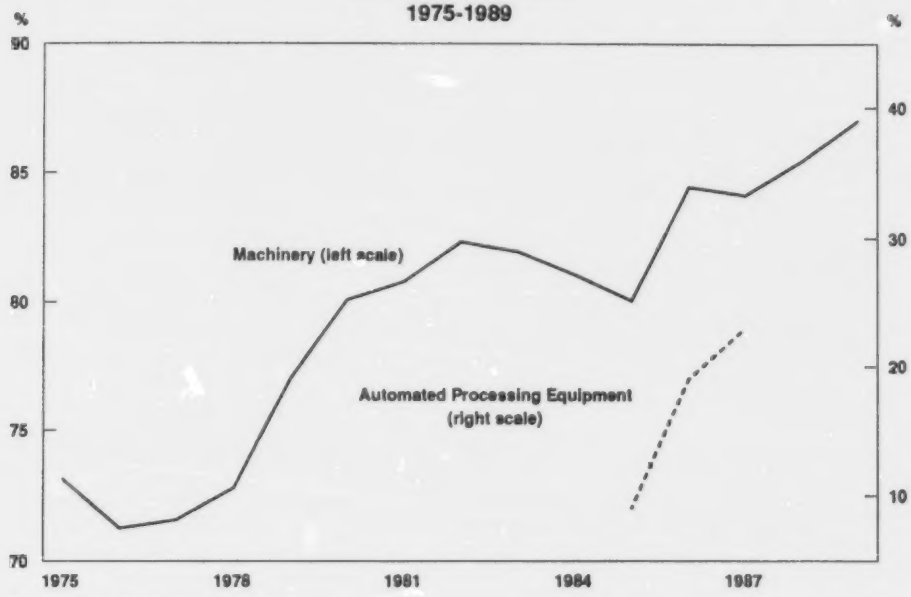
PRODUCTIVITY AND CAPITAL EMPLOYED PER WORKER
ONTARIO MANUFACTURING
1975-1988



Source: Statistics Canada and Data Resources, Inc.

During the past few years, capital investment in manufacturing has been shifting from construction to machinery and equipment: the latter now makes up 85 per cent of total investment. There has been a dramatic shift within machinery and equipment investment towards high-technology equipment such as numerically-controlled machine tools, computer-assisted design, and computer-assisted manufacturing systems.

MACHINERY AS A SHARE OF CAPITAL EXPENDITURES IN MANUFACTURING 1975-1989



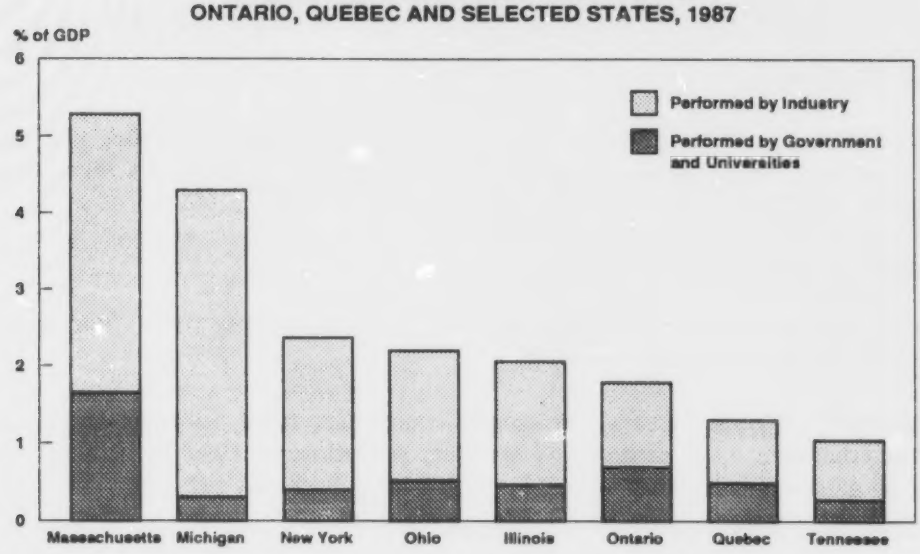
Source: Statistics Canada.

Industrial R and D Effort

Although Ontario leads Canada in research and development performance, it lags when compared to most competing states. This is true both for R and D performed by industry and for total R and D.

The technological position of Ontario firms is stronger than an examination of aggregate R and D statistics alone might suggest. Some Canadian-owned firms approach or even exceed the R and D efforts of their competitors in the United States. Foreign-owned firms generally perform less R and D in Canada than either Canadian-owned firms or firms in the United States in the same industry, but their competitiveness is strengthened by technology transfer from their parent corporations and other international affiliates. In some cases, however, technology is transferred only with a lag.

RESEARCH & DEVELOPMENT PERFORMANCE
ONTARIO, QUEBEC AND SELECTED STATES, 1987

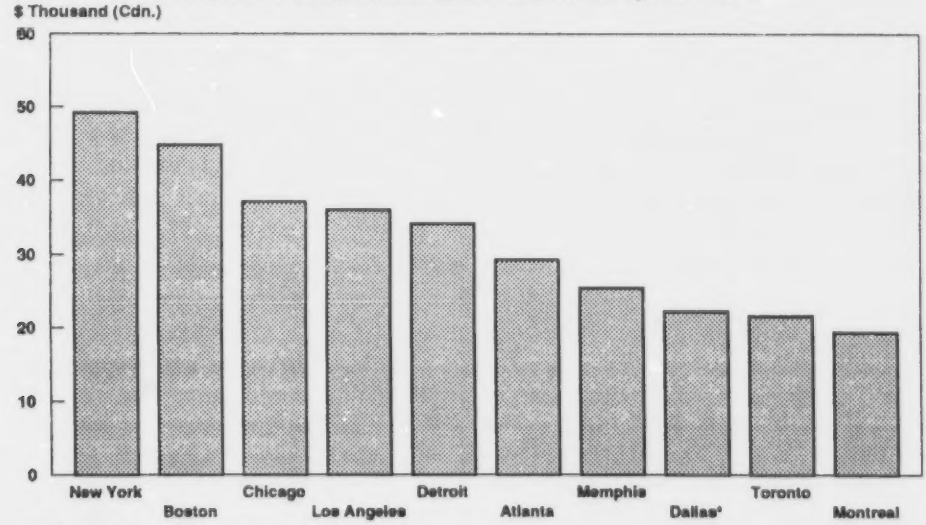


Source: Statistics Canada, U.S. National Science Foundation, U.S. Department of Commerce and Ontario Ministry of Treasury and Economics.

Energy Costs

Ontario industry has enjoyed a competitive advantage in its overall energy costs compared to the United States. With the deregulation of oil and natural gas markets, prices of these commodities vary little among neighbouring jurisdictions. Electricity continues to be a source of cost-competitiveness for Ontario.

MONTHLY INDUSTRIAL ELECTRICITY BILL, JULY 1989



* March 1989.

Note: Relevant exchange rate is $1 Cdn. = $0.85 U.S.
Based on industrial user with 400,000 kWh consumption and peak demand of 1,000 kW.

Source: Ontario Hydro and the Tennessee Valley Authority.

ONTARIO FISCAL REVIEW

Revenue Profile*

As of September 30, 1989, it is estimated that 1989-90 Provincial revenues will amount to over $40.7 billion. This section provides a brief overview of Ontario's revenue structure and describes some key characteristics.

Composition of Provincial Revenues

The Province's revenue sources include taxation, transfer payments from the federal government and other budgetary revenue.

The three major taxation sources -- personal income tax, retail sales tax and corporations tax -- will contribute approximately 64 per cent of estimated 1989-90 budgetary revenue. Taxation of gasoline and diesel fuels will contribute a further 4 per cent. In total, 74 per cent of 1989-90 revenue will be raised through taxation.

Transfer payments from the federal government will account for 13 per cent of 1989-90 revenue, a decline from 19 per cent of revenues in 1979-80.

Other revenue sources include fees and licences, LCBO profits, interest on investments and lottery profit revenue. These sources will contribute 13 per cent of this year's revenue.

The following chart shows the Ontario budgetary revenue structure.

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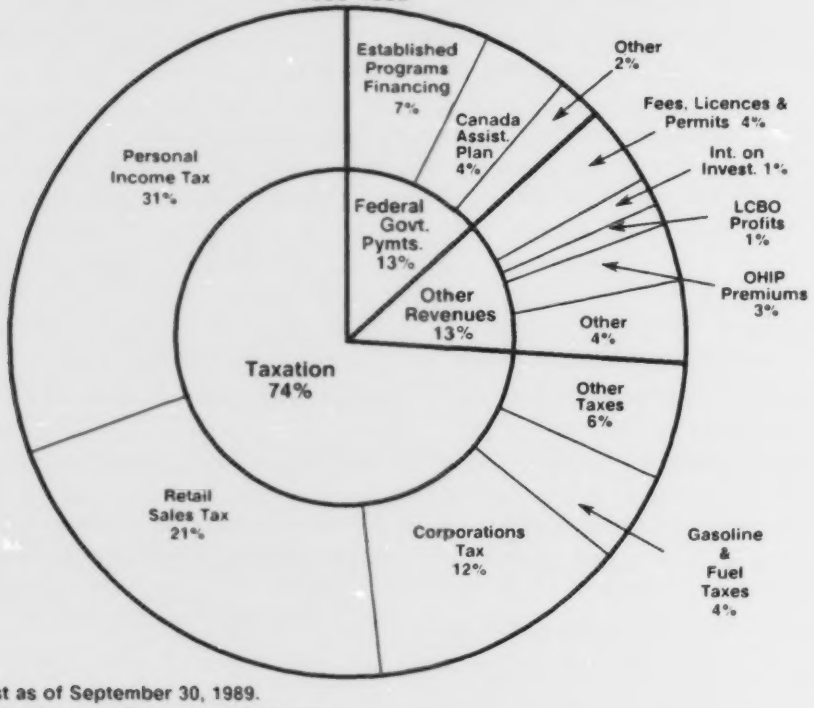
* All Ontario revenue figures for 1989-90 are based on the September 30, 1989 Ontario Finances.

COMPOSITION OF ONTARIO BUDGETARY REVENUES
1989-1990*



* Forecast as of September 30, 1989.
Source: Ontario Ministry of Treasury and Economics.

Recent Developments in Revenue Policy

Canadian Tax Reform

The federal government has announced its intention to proceed with the implementation of a new federal sales tax. The new federal Goods and Services Tax (GST) is scheduled to take effect on January 1, 1991 as outlined in a technical paper released August 8, 1989. The federal proposal has significant implications for Ontario's economy, social programs and fiscal position. The federal proposal is still under review and Ontario feels it is important that the federal government consult with the provinces as the details become finalized.

Health Care Financing Reform

The fundamental principle of Ontario's health care system is to provide all Ontarians with universal access to quality health care. In 1989-90, Ministry of Health expenditures will total $13.9 billion, an increase of 10.7 per cent over 1988-89. As a share of total Provincial spending, the Ministry of Health accounts for 33 per cent, up from 28 per cent a decade ago.

As will be indicated in the Expenditure Profile section on health care, health care expenditures have increased at an average annual rate of 12.5 per cent from 1979-80 to 1989-90. Over the same period, revenues from Ontario Health Insurance Premiums (OHIP) have increased at an average annual rate of 5.6 per cent.

In 1984-85, OHIP premiums funded 19 per cent of total health care costs. For this fiscal year, OHIP premiums would have represented 13 per cent of health care expenditures. If no action had been taken, OHIP premium revenue would have continued to decline as a percentage of total health care costs.

At the same time, the federal government has reduced its support for health care under Established Programs Financing. Contributions have declined by a total of approximately $3 billion over the past three years. The steady decline of OHIP premiums as a share of health care costs, in combination with federal government retrenchment in the funding of health care, has placed an increased pressure on the Province to fund health care programs from other revenue sources.

OHIP premiums, despite several steps taken in recent years to broaden the scope of premium assistance, impose an unfair burden on lower income groups. The Social Assistance Review Committee recommended that OHIP premiums be abolished, as this would greatly improve access to health care, particularly preventive health care, for many low-income people.

This need was recognized by the Government in 1985 when a commitment was made to eliminate OHIP premiums. In keeping with the 1985 promise, the 1989 Ontario Budget announced that, effective January 1, 1990, OHIP premium payments will be eliminated and replaced by revenue from the new Employer Health Tax (EHT).

The elimination of OHIP premiums represents a $1 billion benefit to individuals and families in 1990. Those who pay premiums directly and those who pay all or a portion of premiums through group plans will realize $550 million in premium savings. Those with employer-paid premiums will realize $450 million in personal income tax reductions, as employer-paid premiums are a taxable benefit subject to personal income tax.

Historically, the funding for health care has been shared by people and employers. Each realizes benefits from Ontario's quality health care system. To maintain balance in the funding of health care, Ontario's personal income tax rate will be increased by one percentage point, beginning January 1, 1990. Relative to premiums, use of the personal income tax system represents a more progressive method of funding Ontario's health care system.

To assist low-income groups, an additional 50,000 people will benefit from an enrichment to the Ontario Tax Reduction program. In total, 365,000 low-income individuals liable for basic federal income tax will be exempt from Ontario personal income tax and another 195,000 will benefit from reduced Ontario personal income tax.

The EHT will ensure that all employers contribute to the funding of health care. This is a more reasonable approach than the current patchwork that has many employers paying all premiums for their employees and others contributing nothing at all.

The EHT will be applied to employers' total Ontario remuneration, which includes gross wages and salaries, bonuses, commissions and taxable benefits. The general EHT rate will be 1.95 per cent of the employer's Ontario payroll. In recognition of their unique circumstance, small employers with annual payrolls not exceeding $200,000 will be eligible for a special half-rate of 0.98 per cent. Employers with annual payrolls from $200,001 to $400,000 will be eligible for graduated rates between 0.98 per cent and 1.95 per cent. Employers with annual payrolls not exceeding $400,000 will be eligible to remit EHT payments quarterly instead of monthly. The option of quarterly remittances will be available to about 85 per cent of employers in Ontario, and will provide them with greater cash flow flexibility and reduced administration and compliance costs.

Employers with annual payrolls exceeding $400,000 will be required to remit their first instalment in January 1990, based either on the payroll of the previous month or estimated January payroll. Employers with annual payrolls not exceeding $400,000 will be able to remit their first payment in April 1990 for the payroll of the previous three months.

The EHT is estimated to fund about 16 per cent of total health care costs and will generate about $2.1 billion in net revenue for health care on a full-year basis.

The EHT is estimated to increase the net costs for business by about $553 million on a full-year basis. Employers paying OHIP premiums on behalf of their employees will benefit from the elimination of premiums. Employers subject to income tax will be able to reduce their income tax, as EHT will be deductible for income tax purposes.

The combination of OHIP premiums and EHT revenue will yield an estimated $1,790 million to the Province in 1989-90. This represents an increase of only 2.6 per cent over last year's OHIP premiums, which provided $1,745 million.

Transportation Capital Financing Plan

The 1989 Ontario Budget introduced a number of measures to provide for the new Transportation Capital Program, which will provide $2 billion over five years to improve and expand the existing transportation network.

The Commercial Concentration Tax (CCT), which will be effective as of January 1, 1990, imposes a tax of $1 per square foot on office buildings, shopping centres, freestanding retail outlets and hotels in the Greater Toronto Area that have gross areas in excess of 200,000 square feet. The first 200,000 square feet of these structures will be exempt. In addition, the CCT will be levied on the total square footage of all commercial paid public parking lots and garages, regardless of size.

The rate of tax on gasoline and diesel fuel was increased by one cent per litre. The tax on gasoline will increase an additional one cent per litre on January 1, 1990.

Passenger motor vehicle registration fees were increased from $54 to $66 in Southern Ontario and from $27 to $33 in Northern Ontario. Fees were increased a further $24, to a total of $90, for residents of the Greater Toronto Area.

Environmental Initiatives

The 1989 Ontario Budget introduced a number of new initiatives to help support the Government's environmental programs. The Budget provided a 16.4 per cent increase in funding for the Ministry of The Environment over the previous year.

A tax of $5 was imposed on the purchase of each new pneumatic tire, including each new tire purchased as part of a vehicle. Very small tires, such as bicycle tires and those used for home and garden equipment (e.g., tires for wheelbarrows, lawn mowers and roto-tillers) are exempt.

A tax was also imposed on the purchase of new fuel-inefficient passenger cars -- those with highway fuel consumption ratings of 9.5 litres per 100 kilometres or greater. The tax increases as a car's fuel efficiency decreases. Tax levels of $600, $1,200, $2,200 and $3,500 apply to four classes of fuel-inefficient cars.

A disposal charge of five cents, including 12 per cent Retail Sales Tax, will be applied on all beverage alcohol containers for which there is no deposit or recycling system.

The 1989 Budget applied the Retail Sales Tax to pesticides and fertilizers. Purchases by farmers are still exempt.

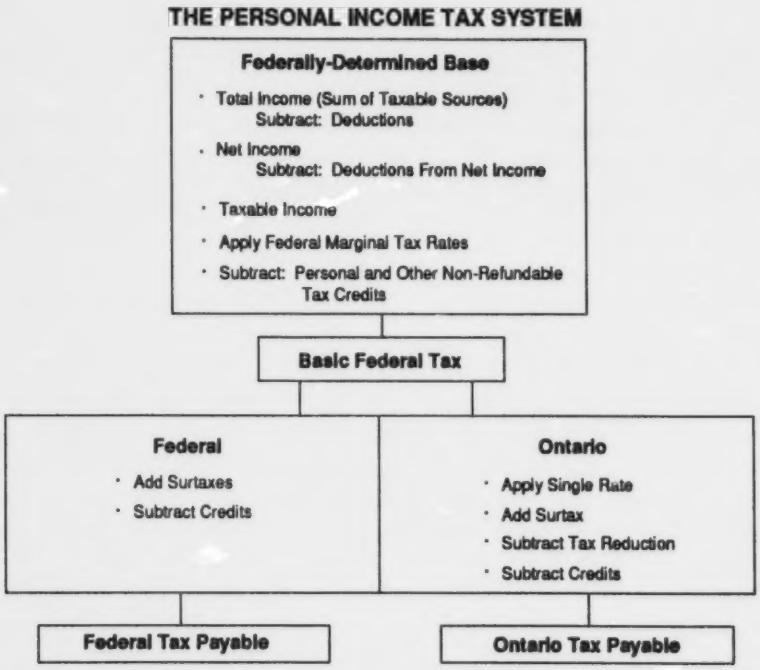
In order to promote environmentally safe production processes, the Current Cost Adjustment under the corporate income tax was expanded to include air and water pollution control equipment.

Description of the Major Taxation Sources

Personal Income Tax

Under the terms of the Tax Collection Agreement between the Government of Canada and the Government of Ontario, the federal government collects and administers the Ontario Personal Income Tax on behalf of the Province. The federal government determines the tax base by establishing the definition of taxable income. Basic Federal Tax is calculated by applying the federal marginal tax rate structure to the taxable income base and deducting specified non-refundable credits. Federal tax payable is then determined by applying federal surtaxes and deducting federal credits.

The diagram below illustrates the calculation of federal and Ontario personal income tax payable.



The federal marginal tax rates for 1989, including both the general federal surtax and the high-income federal surtax, range from 17.68 per cent on taxable income in the lowest tax bracket to 30.60 per cent on taxable income in the highest tax bracket.

Basic Ontario Income Tax is defined as a percentage of Basic Federal Tax. For 1989, based on a statutory rate of 52 per cent of Basic Federal Tax, Ontario's personal income tax rates on taxable income range from 8.84 per cent to 15.08 per cent. The statutory rate will be increased to 53 per cent in 1990. The Provincial tax rate structure for 1989 is shown in Table 1. In addition, a surtax of 10 per cent is applied to Basic Ontario Income Tax in excess of $10,000. The Ontario surtax increases the top Ontario marginal tax rate

to 16.59 per cent, and in conjunction with the high-income federal surtax yields a top combined federal and Ontario marginal tax rate of 47.18 per cent. At the other end of the income scale, the Ontario Tax Reduction program eliminates Ontario income tax payable of $150 or less, for low-income taxpayers. Ontario income tax accounts for roughly one-third of an individual's total income tax.

Federal and Ontario Marginal Personal Income Tax Rates, 1989 **Table 1**

Taxable Income $	Basic Federal Rate %	Federal PIT Rate* %	Ontario PIT Rate** %	Combined Federal/Ontario PIT Rates %
Up to 27,803	17.0	17.68	8.84	26.52
27,804 - 55,605	26.0	27.04	13.52	40.56
Over 55,605	29.0	30.16	15.08	45.24

* Includes the general federal surtax only.
** Does not include the Ontario Tax Reduction or the Ontario surtax.

With a few exceptions, such as social assistance payments and lottery winnings, all sources of personal income are subject to tax. Deductions and non-refundable tax credits are provided for certain personal and income-earning expenses. Provisions in the personal income tax system also support investment and saving for retirement, as illustrated in the section on tax expenditures.* Appendix I highlights the major tax expenditures for these and other activities.

The Province provides special programs to relieve tax burdens on low-income Ontarians. Under the Ontario Tax Reduction program, 330,000 low-income taxfilers will pay no Ontario income tax this year. There is no comparable federal tax reduction for low-income taxpayers. In addition, Ontario provides refundable property and sales tax credits through the Ontario Tax Credit (OTC) program.

Corporations Taxes

The Province of Ontario levies the following taxes specifically on the corporate sector: Corporations Income Tax, Capital Tax and Insurance Premiums Tax. Mining companies are also subject to the Mining Tax. In addition, upon legislative approval, the Employer Health Tax (EHT) and Commercial Concentration Tax (CCT) will be levied in 1990.

The largest source of corporations tax revenue is the corporate income tax. Ontario sets its own corporate income tax base and rate structure for corporations located in the province. Alberta and Quebec also administer their own corporate income tax. All other provinces

* Tax expenditures are specific incentives in the tax structure that reduce the normal amount of tax paid to a lower or zero amount. The value of a tax expenditure is calculated as the revenue foregone.

have entered into corporate Tax Collection Agreements with the federal government. Tax is imposed on gross corporate revenues earned in the taxation year less allowable expenses. Various corporate activities and investments receive special treatment through lower rates or accelerated deductions. The estimated cost of these measures is listed in Appendix I.

The 1989 general corporate income tax rate is 15.5 per cent of taxable income. Income from manufacturing and processing operations, mining, logging, farming and fishing is taxed at the rate of 14.5 per cent. The 1989 small business tax rate in Ontario is 10.0 per cent.

All corporations in Ontario, with the exception of insurance companies, are required to pay capital tax based on their paid-up capital. Small corporations with taxable capital under $2 million either qualify for an exemption or pay tax at reduced rates. All larger corporations must pay tax on capital employed, regardless of income tax paid. The capital tax ensures that a minimum amount of corporations tax is paid by all large Ontario corporations. Insurance companies pay insurance premium tax based on the amount of insurance premiums received in respect of Ontario policies. The recently announced Ontario Motorist Protection Plan will eliminate the insurance premium tax currently imposed on insurers for personal-use automobile premiums written in Ontario. Implementation of the Plan is scheduled for 1990. Capital taxes and insurance premium taxes are deductible expenses for federal and Ontario corporate income tax purposes.

Retail Sales Tax

The Retail Sales Tax is payable on the sale of most goods and on certain services. The tax is calculated as a specific percentage of the retail price to the consumer. The general Retail Sales Tax rate is 8 per cent. Three other rates apply to specific goods and services: 5 per cent on transient accommodation; 10 per cent on admission fees over $4 and beverage alcohol products sold at licensed establishments; and 12 per cent on beverage alcohol products sold at retail outlets.

A number of goods are specifically exempt from the Retail Sales Tax. Exempt items include: groceries; energy used for heating, cooking and lighting; children's clothing; footwear costing $30 or less; prescription drugs; specified reading material; and production machinery and equipment. Most services are excluded from the Retail Sales Tax base. The major Retail Sales Tax expenditures are listed in Appendix I.

The Province determines both the Retail Sales Tax base and rates. Registered vendors collect the tax as agents of the Province and remit it to the Government.

Motive Fuel Taxes

Ontario levies tax on motive fuels purchased in Ontario under the authority of two Acts: the *Gasoline Tax Act* and the *Fuel Tax Act (1981)*. Certain non-conventional fuels such as natural gas, alcohol (used alone or blended with another fuel) and other manufactured gases are exempt. As well, fuels used for heating and cooking and for off-road use in farming, commercial fishing and for industrial, commercial and institutional purchases qualify for exemption or full rebate of tax. Fuel taxes are levied on a per litre basis.

The Provincial tax on unleaded gasoline is 10.3 cents per litre and on leaded gasoline is 13.3 cents per litre. On January 1, 1990 these rates will increase by one cent per litre, to 11.3 cents per litre for unleaded gasoline and 14.3 cents per litre for leaded gasoline. It should be noted that sales of leaded gasoline will end on December 1, 1990.

Propane used to power licensed motor vehicles is subject to a tax of 2.3 cents per litre, increasing to 4.3 cents per litre on January 1, 1990.

All aviation fuels purchased in Ontario are subject to a tax of 2.1 cents per litre.

Diesel fuel purchased in Ontario for use in licensed on-road motor vehicles is subject to a tax of 10.9 cents per litre. A system of colouration is in place to distinguish diesel fuel sold for exempt purposes, such as farming.

A tax of 3.4 cents per litre is applied to diesel fuel used to power railroad locomotives. This tax is based on fuel use in Ontario and is allocated by applying the ratio of Ontario distance travelled to total distance travelled against total fuel purchased.

Per Point Yields

Table 2 shows the 1989-90 estimated average revenue yield of selected taxes on a per point basis. The estimated yields are based on a full year's revenue and in each case the tax points relate to a specific base and unit of tax, such as percentage point of tax or per litre of gasoline. For example, one percentage point of the Retail Sales Tax at the general rate is estimated to yield approximately $1 billion.

Estimated Average Per Point Yield, 1989-90 Full-Year **Table 2**
($ Million)

Retail Sales Tax (RST)		
8% - General	999	per percentage point
5% - Transient Accommodation	14	per percentage point
10% - Alcohol (Licensed Establishments) and Admission Fees	19	per percentage point
12% - Alcohol (Retail Outlets)	32	per percentage point
All RST rates	**1,064**	**per percentage point**
Personal Income Tax (PIT) -52% of Basic Federal Tax	238	per percentage point
Ontario (PIT) Surtax	12	per percentage point
Corporate Income Tax (CIT)		
15.5% - General	114	per percentage point
14.5% - Manufacturing and Processing, Mining, Fishing, Logging and Farming	88	per percentage point
10% - Small Business	79	per percentage point
All CIT rates	**281**	**per percentage point**
Capital Tax	126	per 1/10 point
Tobacco Tax (Cigarettes)	79	10¢ per pack of 20
Motive Fuel Taxes		
Gasoline and Aviation Fuel	153	1¢ per litre
Road and Rail Diesel	37	1¢ per litre
All Fuel tax rates	**190**	**1¢ per litre**
Employer Health Tax (0.98-1.95%)	128	per 1/10 point
Land Transfer Tax (LTT)		
0.5 % on first $55,000	21	per 1/10 point
1.0% between $55,000 and $250,000	44	per 1/10 point
1.5% over $250,000	13	per 1/10 point
2.0% above $400,000, Single Family Dwellings Only	1	per 1/10 point
All LTT rates	**79**	**per 1/10 point**

Note: See text for interpretation of these data.
Source: Ontario Ministry of Treasury and Economics.

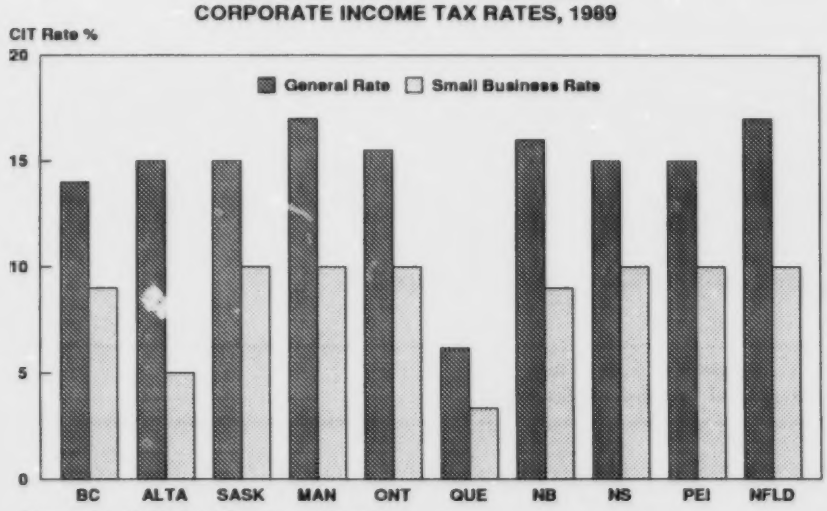
Interprovincial Tax Rate Comparisons

Interprovincial tax rate comparisons must be viewed with caution. Differences in taxable bases are particularly important in interprovincial comparisons and are best illustrated by comparing the application of the Retail Sales Tax. Significant interprovincial differences in Retail Sales Tax exemptions exist for clothing, footwear, prepared food products, heating fuels and electricity, and transient accommodation. Interprovincial differences also exist in the corporate income tax treatment of various activities. For example, as an incentive for research and development, Ontario provides an extra deduction called the Super Allowance while Quebec provides tax credits. In the personal income tax area, some provinces apply tax reductions, credits, flat taxes, or surtaxes which affect both marginal and effective tax rates.

Corporations Income Tax

As illustrated in the following chart, Ontario's general and small business Corporations Income Tax rates are comparable with those in most Canadian provinces. Corporations Income Tax is only one element of the composite Ontario corporate tax burden. Capital taxes, sales taxes, health taxes and social and employment security taxes must also be taken into account when comparing corporate tax burdens between jurisdictions. While Quebec has a lower rate of corporate income tax, the lower rates of capital tax and health tax in Ontario help to balance the corporate tax burden. For example, Quebec's general capital tax rate is 0.5 per cent as compared to 0.3 per cent for Ontario. Also, Ontario's general Employer Health Tax rate is 1.95 per cent of payroll. The payroll tax which is levied in Quebec with respect to health care is 3.36 per cent.

INTERPROVINCIAL TAX COMPARISON
CORPORATE INCOME TAX RATES, 1989

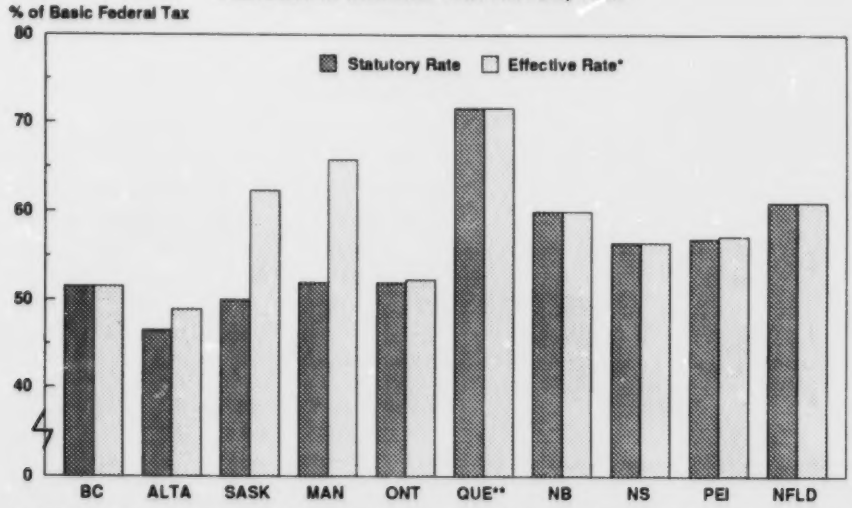


Source: Ontario Ministry of Treasury and Economics.

Personal Income Tax

Provincial Personal Income Tax rates and provincial Personal Income Tax revenues as a percentage of Basic Federal Tax are illustrated below. For 1989, Ontario's effective rate is 52.3 per cent when the Ontario Tax Reduction program and surtax are taken into account.

INTERPROVINCIAL TAX COMPARISON
PERSONAL INCOME TAX RATES, 1989



* Effective rate is total provincial income tax revenue (including any surtaxes and flat taxes, less any tax reductions) as a percentage of Basic Federal Tax assessed in the province.

** Estimated rate: Quebec does not impose tax as a percentage of Basic Federal Tax.

Source: Ontario Ministry of Treasury and Economics.

Table 3 shows the provincial and combined federal-provincial top marginal Personal Income Tax rates for 1989. Ontario has the fourth-lowest top marginal tax rate.

Top Marginal Personal Income Tax Rates*, 1989 **Table 3**
(Per Cent)

	B.C.	Alta.	Sask.	Man.	Ontario	Quebec	N.B.	N.S.	P.E.I.	Nfld.
Provincial	14.9	15.1	18.5	19.1	16.6	24.0	17.4	16.4	18.2	17.7
Combined Federal-Provincial	45.5	45.7	49.1	49.7	47.2	49.8	48.0	47.0	48.8	48.3
Rank	1	2	8	9	4	10	5	3	7	6

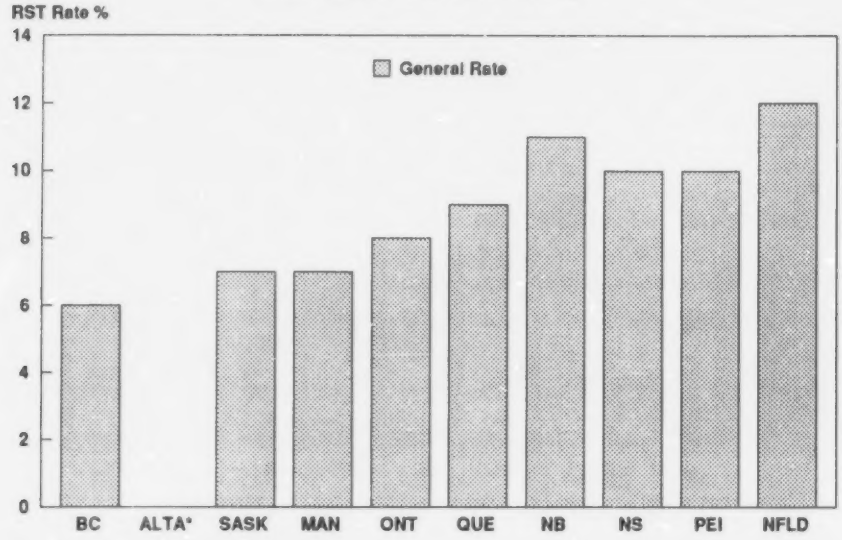
* Includes federal and provincial surtaxes.

Source: Ontario Ministry of Treasury and Economics.

Retail Sales Tax

General Retail Sales Tax rates in Canada range from zero per cent in Alberta to 12 per cent in Newfoundland. Ontario's rate of 8 per cent is in the mid-range of rates applied by all taxing jurisdictions.

INTERPROVINCIAL TAX COMPARISON
RETAIL SALES TAX RATES, 1989



* No provincial sales tax is imposed.
Source: Ontario Ministry of Treasury and Economics and provincial tax statutes.

Tax Expenditures

Tax expenditures are taxes that governments choose not to collect in order to redistribute income more fairly, or to encourage individuals and corporations to undertake desired activities. Tax expenditures are exceptions to the normal tax rules and are often used as alternatives to direct spending to achieve particular policy objectives.

There are four types of tax expenditures: exemptions, deductions and allowances, credits, and special reduced rates of tax. Ontario's tax system incorporates all four.

Table 4 lists the ten largest tax expenditures within Ontario's sole jurisdiction, along with an estimate of foregone revenue for each expenditure in 1989-90. Because many of these tax expenditures are interdependent, these estimates cannot be added to derive a total value of foregone revenue. A more complete list of Ontario's major tax expenditures, along with a brief description of each, is contained in Appendix I.

In addition, estimates of the impact of tax changes on Ontario's tax expenditures are provided in the annual Ontario Budget.

Ten Largest Tax Expenditures
Within Ontario's Sole Jurisdiction in 1989-90
($ Million)

Table 4

	Ontario Revenue Foregone
Retail Sales Tax Expenditures	
Professional Services	3,981
Commercial Services	2,189
Energy Goods (including motive fuels)	1,836
Personal Services	1,831
Basic Groceries	1,200
Production Machinery Goods	909
Personal Income Tax Expenditures	
Ontario Health Insurance Plan Premium Assistance*	595
Ontario Tax Grants to Seniors*	505
Ontario Property and Sales Tax Credits	444
Corporate Income Tax Expenditures	
Small Business Deduction	435

* Although not directly part of the Personal Income Tax system, these tax expenditures provide benefits to individuals. OHIP premium payments and assistance end December 31, 1989.

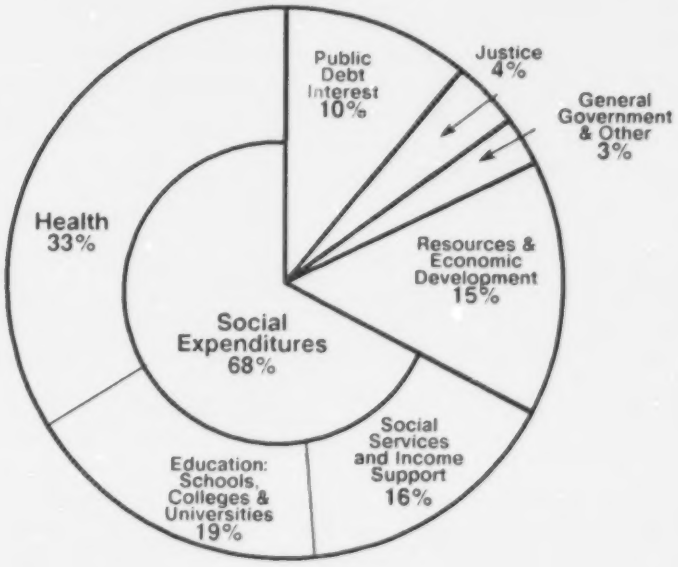
Source: Ontario Ministry of Treasury and Economics.

Expenditure Profile

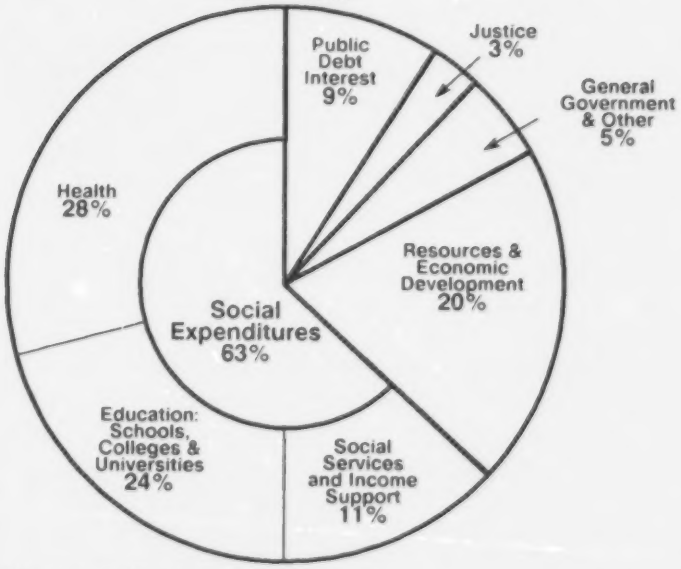
As of September 30, 1989, it is estimated that 1989-90 Provincial expenditures will amount to $41.3 billion. More than two-thirds of all Provincial spending is on social programs, with the balance allocated to resources and economic development, justice, public debt interest, and other government activities. The charts below illustrate the proportion of government spending by major expenditure area in 1989-90 and 1979-80.

DISTRIBUTION OF ONTARIO'S EXPENDITURES

1989-1990


Public Debt Interest 10%
Justice 4%
General Government & Other 3%
Resources & Economic Development 15%
Social Services and Income Support 16%
Education: Schools, Colleges & Universities 19%
Health 33%
Social Expenditures 68%

1979-1980


Public Debt Interest 9%
Justice 3%
General Government & Other 5%
Resources & Economic Development 20%
Social Services and Income Support 11%
Education: Schools, Colleges & Universities 24%
Health 28%
Social Expenditures 63%

Source: Ontario Ministry of Treasury and Economics

The charts indicate that there has been an appreciable shift in the composition of Provincial expenditures. The dominant feature of this shifting pattern is a notable increase in the share of spending allocated to health care. The Ministry of Health is expected to account for 33 per cent of expenditures in 1989-90, compared to 28 per cent in 1979-80.

The proportion of Provincial spending allocated to social services and income support has also increased significantly. This area represented 11 per cent of spending in 1979-80, and accounts for 16 per cent of expenditures in 1989-90.

The increasing share of expenditures taken up by health and social services and income support has reduced the share available for education and for resources and economic development. Education expenditures represented 24 per cent of Provincial spending in 1979-80, and are estimated at 19 per cent in 1989-90. The share of Provincial spending dedicated to resources and economic development has fallen from 20 per cent in 1979-80 to an estimated 15 per cent in 1989-90.

The increasing share of spending dedicated to health care and social services and income support is of particular fiscal importance, as these programs influence the resources available for all other Provincial programs, now and in the future.

Health Care

In the period from 1979-80 to 1989-90, health care expenditures increased at an average annual rate of 12.5 per cent. After allowing for population growth, which averaged 1.2 per cent per annum over the period, per capita health care spending increased at an average rate of 11.2 per cent per year.

The largest components of Ministry of Health expenditures are the Operation of Hospitals, the Ontario Health Insurance Plan (OHIP) and the Ontario Drug Benefit Plan (ODB). In 1989-90, these three programs will account for almost 80 per cent of Ministry of Health expenditures.

Expenditures for the Operation of Hospitals, the largest component of health care expenditures, increased at an average annual rate of 11 per cent over the 1979-80 to 1989-90 period. Spending during this period has almost tripled from $2.1 billion to $6.0 billion. However, the share of the Ministry of Health budget dedicated to the Operation of Hospitals has declined from 50 per cent in 1979-80 to 43 per cent in 1989-90.

OHIP costs have increased at an average annual rate of 14.4 per cent over the period, almost quadrupling total OHIP outlays from $1.1 billion in 1979-80 to $4.3 billion in 1989-90, and increasing the program's share of Ministry of Health expenditures from 26 per cent to 31 per cent. Greater utilization and an average annual 3.6 per cent increase in the number of physicians over the past ten years have contributed to this increase.

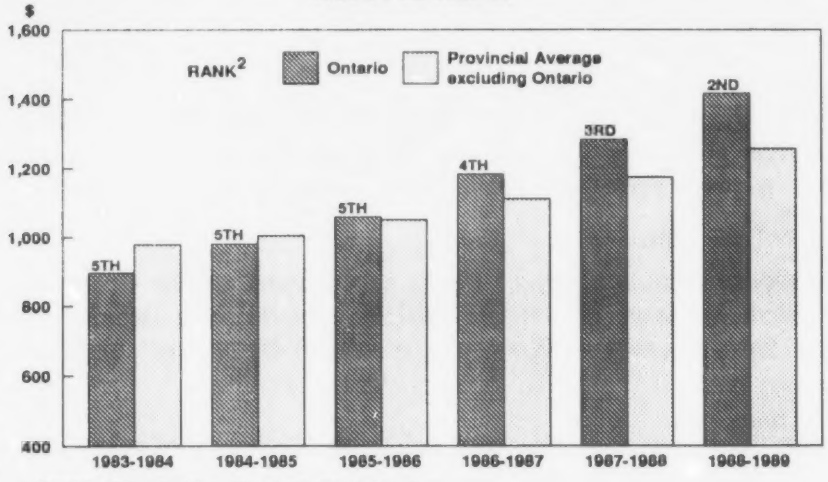
One of the most rapidly growing components of health care costs is the Ontario Drug Benefit Plan. Ministry of Health expenditures on the ODB Plan increased from $107 million in 1979-80 to $659 million in 1989-90. The share of Ministry of Health expenditures allocated

to ODB increased from 2.5 per cent to 4.7 per cent over the period. One factor accounting for this fast growth has been a rapid increase in the size of the eligible population. There are 36 per cent more seniors aged 65 and over in the province in 1989 compared to 1979.

The rapid growth of health care expenditures in Ontario has resulted in a marked increase in Ontario's per capita health care expenditures relative to per capita health care spending in the other provinces. The following chart shows per capita health spending in Ontario compared to the average health care spending in the other nine provinces over the 1983-84 to 1988-89 period.

In 1983-84, Ontario's per capita health care spending, at $896, was about 9 per cent below the average spending in the other provinces of $979 per capita. By 1988-89, Ontario's per capita spending level was $1,416, about 12.5 per cent above the average of $1,259 per capita spent in the other nine provinces. The higher rate of increase in Ontario compared to the other provinces has resulted in Ontario's rank in per capita health care spending increasing from fifth highest in 1983-84 to second highest in 1988-89.

PROVINCIAL HEALTH CARE SPENDING[1] PER CAPITA
1983-84 TO 1988-89



1 Combined Provincial and local government sectors.
2 Ontario's rank among provinces, from highest to lowest.
Source: Statistics Canada.

Social Services and Income Support

The increasing share of Provincial spending dedicated to social services and income support is largely the result of greater expenditures by the Ministry of Community and Social Services (MCSS). Between 1979-80 and 1989-90, spending by MCSS grew at an average annual rate of 14 per cent.

Between 1979-80 and 1989-90, expenditures on income support increased from $648 million to $2.5 billion, an average annual growth rate of 15 per cent. This growth is attributable to improvements in the average level of benefits provided to social assistance recipients, higher shelter costs, inflation and increases in the numbers of disabled persons and single parents receiving income support.

Programs for seniors have also grown. Operating expenditures on municipal and charitable homes for the aged grew from $120 million in 1979-80 to $360 million in 1989-90, an average annual increase of 12 per cent. Inflation and increased care requirements explain the expenditure growth. In recent years there has also been an expansion of services to help seniors maintain an independent lifestyle in their own communities. Expenditures on community-based programs such as Home Support Services, Elderly Persons Centres, Homemakers and Nurses Services, and the Integrated Homemakers Program grew from $17 million in 1984-85 to $120 million in 1989-90, an average annual growth rate of 48 per cent.

There have also been increases in funding for children's programs, such as Child Care. Between 1984-85 and 1989-90, operating expenditures on Child Care grew from $87 million to $327 million, an average annual growth rate of 30 per cent. The increases reflect expansions in the number of subsidized spaces, improvements in wages paid to child care workers and inflation.

Services provided to persons with developmental handicaps have been enhanced to provide more clients with community accommodation and support to maximize their capacity for independent living. Expenditures have grown from $429 million in 1984-85 to $704 million in 1989-90, an average annual growth rate of almost 11 per cent.

Transfer Payments

Almost three-quarters of the Government's expenditures, or $30.3 billion, are transfer payments to third parties such as hospitals, school boards, universities and municipalities. The principal transfers are listed on the following page.

1989-90 Transfer Payments **Table 5**

	$ Billion	% of Spending
Five Major Transfers		
Hospitals	6.0	14.5
Colleges	0.7	1.7
Universities	1.7	4.1
School Boards	4.2	10.2
Municipalities	4.5	10.9
Other Transfers		
OHIP	4.3	10.4
ODB*	0.8	1.9
Other	8.1	19.6
Total Transfer Payments	30.3	73.3

* Includes drug benefit plans under the Ministry of Health and the Ministry of Community and Social Services.

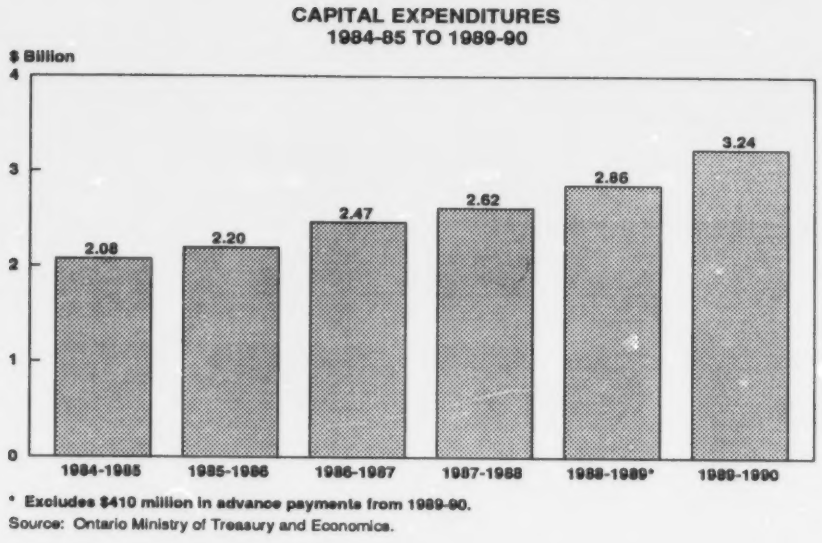
Source: Ontario Ministry of Treasury and Economics.

Non-Transfer Payment Expenditures

The 26.7 per cent of expenditures which are not allocated in the form of transfer payments amount to $11.0 billion. Almost $4.3 billion of non-transfer payments will fund public debt interest. The remaining $6.7 billion will fund institutions and services operated by the Province, such as psychiatric hospitals, correctional facilities, provincial parks, and other government programs, including administration and regulatory activities.

Capital

Approximately $3.2 billion is provided in 1989-90 for capital investments, including investments made by transfer payment recipients. Since 1984-85, Provincial capital expenditures have increased at an average annual rate of 9.3 per cent. The following graph shows the level of capital expenditures in recent years.



* Excludes $410 million in advance payments from 1989-90.
Source: Ontario Ministry of Treasury and Economics.

Summary of Expenditures

Expenditures are expected to grow by $2.6 billion between 1988-89 and 1989-90. The 1989-90 expenditure plan reflects the accelerated payment in 1989-90 of $410 million, which would normally have been paid in 1990-91, including $300 million for education capital and $110 million for colleges and universities capital. A further $823 million, which would have been paid this year, was accelerated and paid in 1988-89, including $300 million for education capital, $110 million for colleges and universities capital, and $413 million for municipal unconditional grants.

Spending Control

Savings and Constraints Measures

The 1988 Budget contained a provision for a Government-wide $500 million expenditure savings and constraints program. This in-year expenditure target was achieved as part of the Government's continuing effort to control spending and improve the efficiency of program delivery.

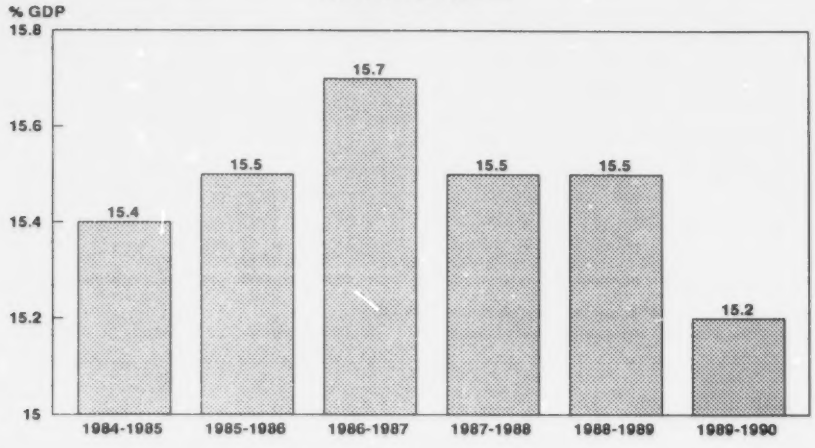
Every ministry contributed to the savings and constraints goal through across-the-board reductions in total salaries and benefits of two per cent and reductions in non-payroll expenditures of six per cent. In addition, some ministry-specific reductions were applied to general program areas based on reduced cash flow requirements.

The 1989 Budget set a target of $200 million in expenditure savings and constraints. As of September 30, 1989, $40 million has been identified. Over the period 1985-86 to 1989-90, savings and constraint measures will have generated a total of $1.1 billion in savings.

Expenditure Indicators

Since 1986-87, Provincial expenditures as a share of the economy have declined. The forecast for 1989-90 is 15.2 per cent of GDP.

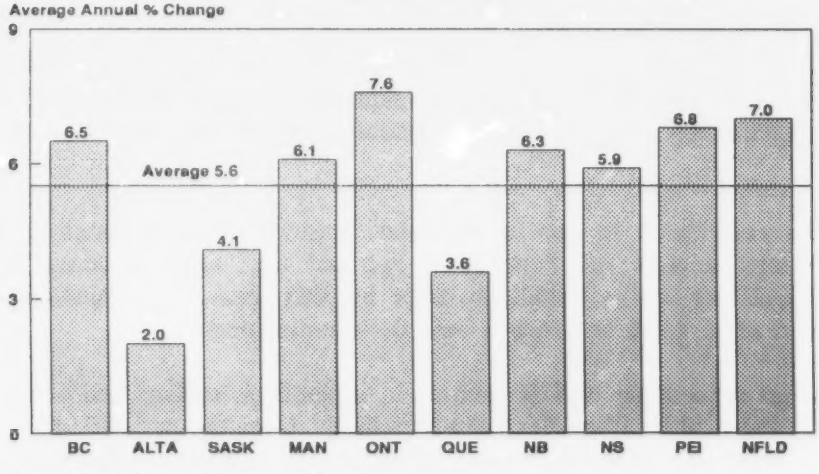
EXPENDITURES AS A SHARE OF THE ECONOMY
1984-85 TO 1989-90



Source: Ontario Ministry of Treasury and Economics.

Relative to the other provinces, Ontario has had the highest rate of growth in per capita expenditures over the past five years. From 1985-86 to 1989-90, the all-province average annual rate of per capita expenditure growth has been 5.6 per cent, compared to Ontario's average rate of 7.6 per cent.

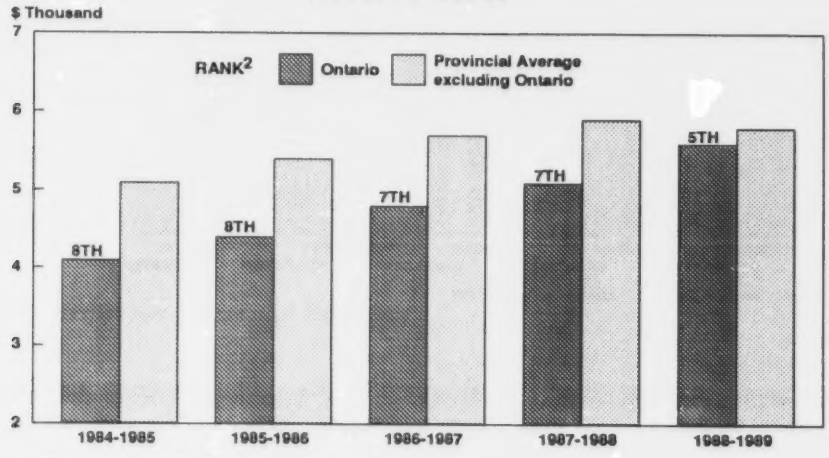
PER CAPITA SPENDING GROWTH
1985-86 TO 1989-90



Source: Ontario Ministry of Treasury and Economics.

Despite high rates of per capita expenditure growth, the level of per capita expenditures in Ontario remains below the average level of other provinces, ranking Ontario fifth among the provinces in per capita spending. However, faster expenditure growth in Ontario is narrowing this spending gap. This trend is shown in the following chart.

TOTAL PROVINCIAL EXPENDITURES [1] PER CAPITA
1984-85 TO 1988-89

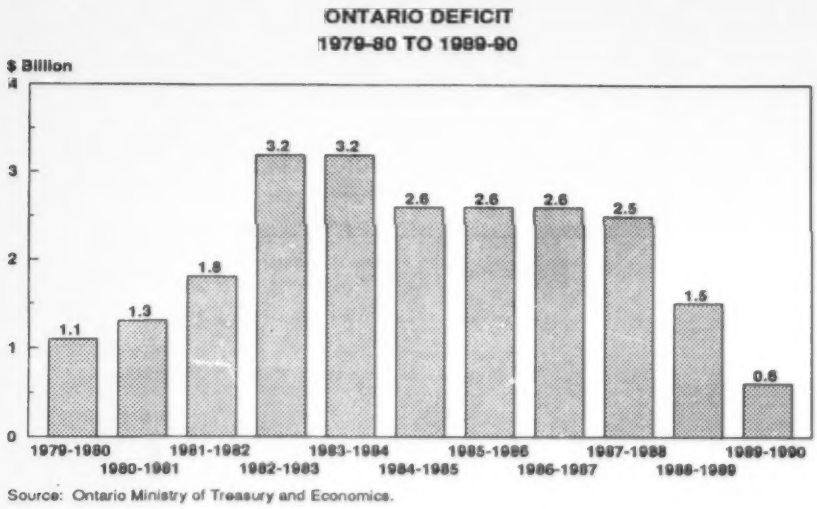


1 Combined Provincial and Local government sectors.
2 Ontario's rank among provinces, from highest to lowest.
Source: Statistics Canada.

Fiscal Indicators

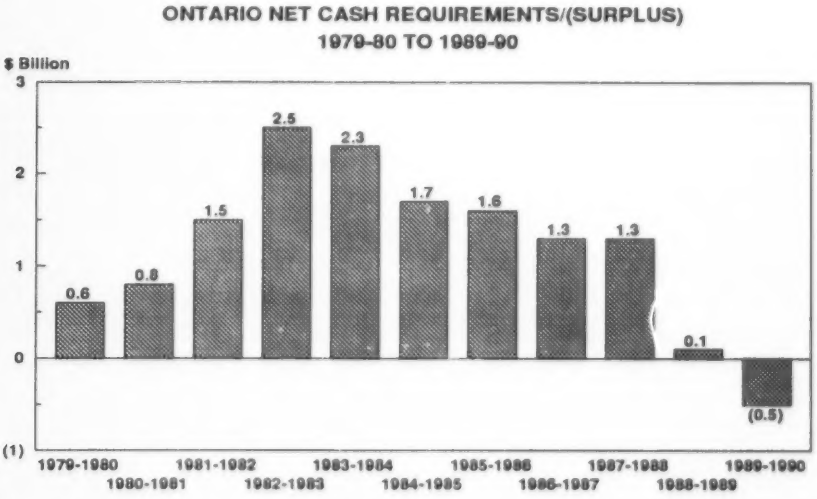
Ontario's fiscal trends can be assessed in terms of commonly used indicators. The following section evaluates the fiscal position of the Province.

Ontario's deficit rose to a level of almost $3.2 billion in 1982-83, but since that time has declined to $1.5 billion in 1988-89, and is forecast to be $0.6 billion in 1989-90, the lowest level since 1974-75.



Source: Ontario Ministry of Treasury and Economics.

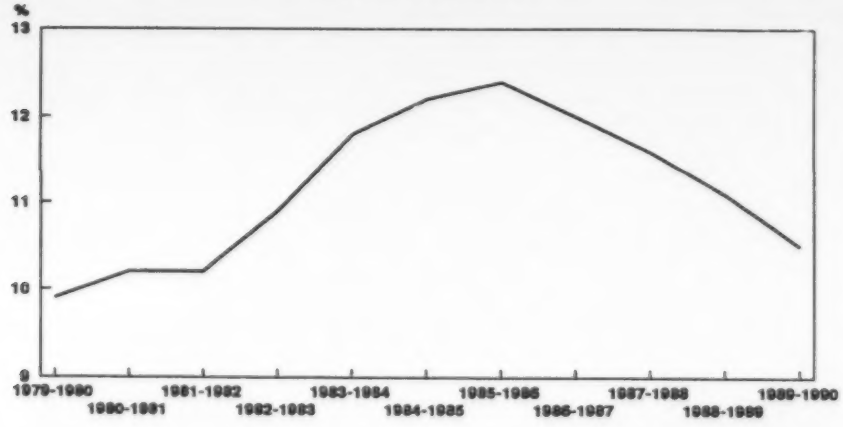
Net cash requirements have been reduced from the $2.5 billion peak level reached in 1982-83 to $50 million in 1988-89. A surplus of $477 million is estimated for 1989-90.



Source: Ontario Ministry of Treasury and Economics.

Ontario's public debt interest costs will be almost $4.3 billion in 1989-90, requiring 10.5 per cent of revenue. By contrast, federal public debt charges in 1989-90 are currently forecast at 35 per cent of federal budgetary revenues. The Ontario proportion continues its downward trend from a high of 12.4 per cent in 1985-86.

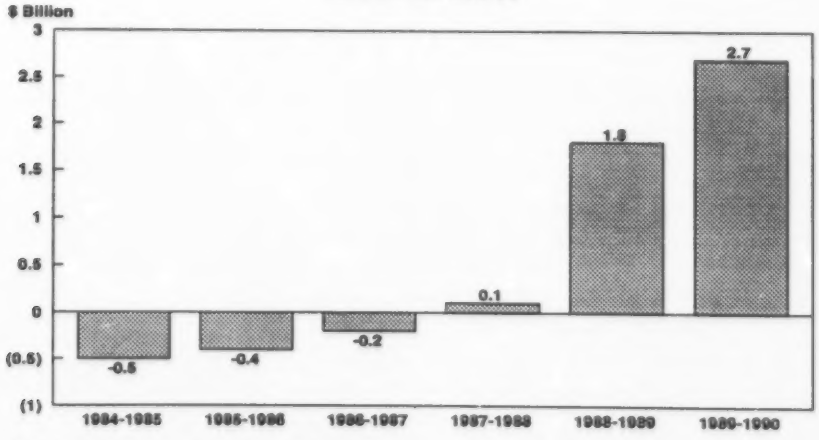
PUBLIC DEBT INTEREST AS A PERCENTAGE OF REVENUE
1979-80 TO 1989-90



Source: Ontario Ministry of Treasury and Economics

Ontario's operating position reflects the Province's ability to pay for day-to-day operating needs from its revenue. Expenditure excludes spending on capital investments. In 1989-90, Ontario's operating position will be in surplus by almost $2.7 billion. This operating surplus will finance 82 per cent of the Province's $3.2 billion capital expenditure program.

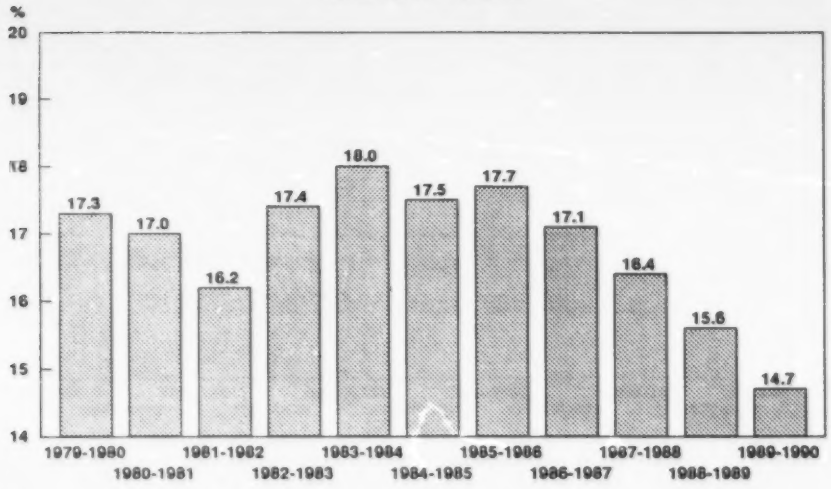
ONTARIO OPERATING POSITION
1984-85 TO 1989-90



Source: Ontario Ministry of Treasury and Economics.

Ontario's total own-purpose debt is expected to be $40.0 billion by the end of 1989-90. Measured as a share of the economy, the debt burden has moderated in the past six years. From a peak of 18.0 per cent of provincial GDP in 1983-84, the debt burden declined to 15.6 per cent in 1988-89. In 1989-90, debt as a share of the economy is expected to decline further to 14.7 per cent.

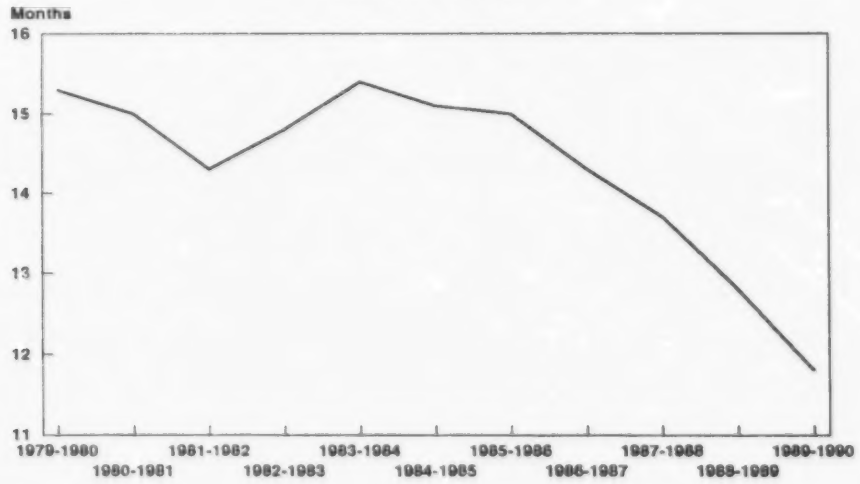
TOTAL OWN-PURPOSE DEBT AS A SHARE OF THE ECONOMY
1979-80 TO 1989-90



Source: Ontario Ministry of Treasury and Economics.

Ontario's ability to carry its total own-purpose debt can also be measured by the number of months of revenue that would be required to repay this debt. The number of months has fallen steadily in the past six years, from 15.4 months in 1983-84 to 12.6 months in 1988-89. In 1989-90, it is expected to fall further to 11.8 months.

MONTHS OF REVENUE TO REPAY TOTAL DEBT
1979-80 TO 1989-90

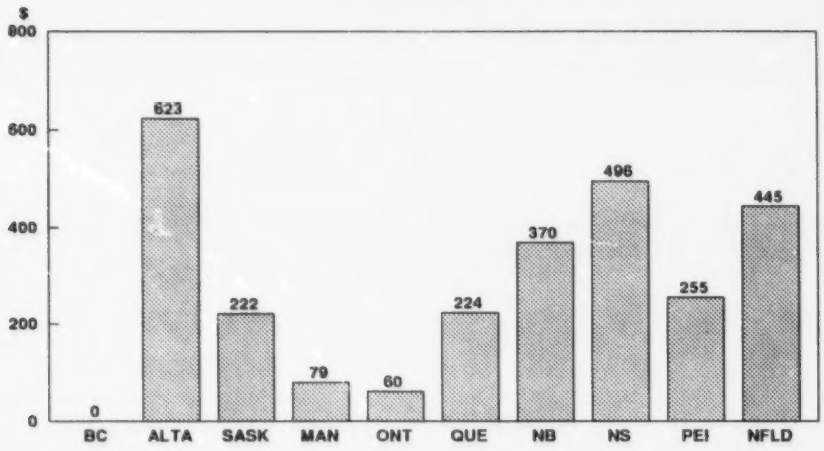


Source: Ontario Ministry of Treasury and Economics.

In addition to its total own-purpose debt, the Province's debt on behalf of Ontario Hydro was $7.8 billion as of March 31, 1989. Ontario Hydro's debt guaranteed by the Province amounted to $19.3 billion as of March 31, 1989.

On an interprovincial basis, Ontario's fiscal performance compares favourably. At $60 per person, Ontario will have the second lowest deficit per capita in 1989-90.

DEFICITS PER CAPITA
1989-1990



Source: Ontario Ministry of Treasury and Economics.

Medium Term Fiscal Outlook

This section describes a projection of the Province's fiscal outlook over the medium term. Projections of Ontario's fiscal position over the period 1990-91 to 1992-93 represent current-trend revenues and expenditures and are based on an assumption of no policy change. The trends outlined below may be altered by either unexpected changes in the economy or by future changes to Government revenue or expenditure policies. As discussed further below, the projected trends do not reflect the potential impacts of the proposed Goods and Services Tax. The imposition of such a tax would also alter the projections presented.

Factors Influencing Expenditure Growth

A number of factors cause expenditures generally to grow at a rate faster than the increase in inflation as measured by the Consumer Price Index (CPI):

- Population increases. Ontario's population has been increasing at an average annual rate of 1.5 per cent for the last five years;

- Demographic changes. For example, an aging population will require the provision of more health and other support services;

- Economic growth. Growth increases demand for Government spending in such areas as highways, housing, municipal infrastructure and recreational facilities; and

- Introduction of new programs or expansion of existing programs. New programs are usually introduced to address emerging social issues such as AIDS, environmental concerns or the need for child care.

These factors have contributed to expenditure growth over the past six years which generally exceeded inflation (CPI) rates by three to five percentage points. In periods of strong economic growth, such as those experienced by Ontario in recent years, expenditure growth in the 7-9 per cent range can be accommodated within the rate of growth of the economy. In the past three years, expenditures have grown at an average of about 1.1 percentage points below the rate of growth in GDP.

When expenditure growth rates exceed the rate of growth in the economy over a sustained period, deficit pressures increase and a build-up in public debt may occur, unless offsetting tax increases are implemented.

Factors Influencing Revenue Growth

The Government receives revenue from a number of sources including taxation, fees and licences, and transfers from the federal government. Not all revenue sources are responsive to economic growth. In fact, only 70 per cent of revenues fall into this category. As a result, revenues from responsive sources such as the Retail Sales Tax and Personal Income Tax must grow substantially faster than the rate of economic growth to maintain overall revenue growth

at rates close to the rate of economic growth. Historically, revenues have increased at approximately 90 per cent of the rate of growth in the GDP.

The 30 per cent of the revenue sources which are not responsive to economic growth are primarily fees which are adjusted at discrete intervals, or federal transfers which are not controlled by the Province. Specific government action is needed to influence the rate of increase in these revenue sources.

Fiscal Projection

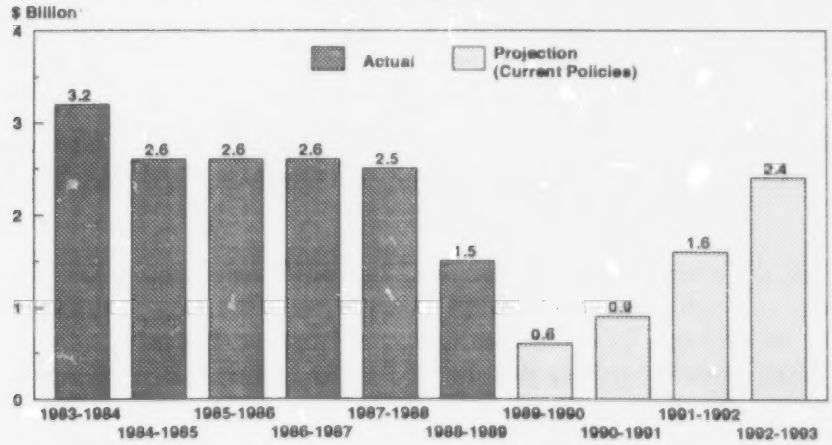
The fiscal projection brings together the trends in revenue and expenditure growth discussed above with the current forecast of economic growth.

The fiscal projection, based on the economic forecast developed by the Ministry of Treasury and Economics, assumes no change in existing revenue policy and a continuation of the 1989-90 revenue structure. Projected revenues are also assumed to grow at their historical rate of 90 per cent of GDP growth. Expenditures are assumed to grow in the future at 8.7 per cent annually, the average experienced over the past three years.

Under this current policy scenario, the deficit would grow from $0.6 billion in 1989-90 to $2.4 billion by 1992-93. As the Provincial revenue base is less than that of expenditures in absolute terms, revenues would have to grow at much faster rates than expenditures to maintain the current deficit level.

It should be emphasized that this projection is based on the assumption of no policy change over the period, and in no way reflects a fiscal target.

ONTARIO DEFICIT PROJECTION [1]
1983-84 TO 1992-93

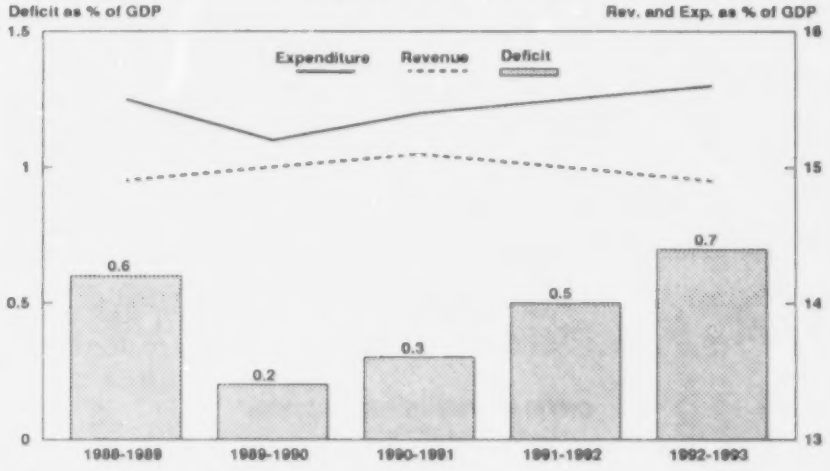


1 Does not include impact of the GST.
Source: Ontario Ministry of Treasury and Economics.

An economic downturn or a recession would have an adverse impact on the Province's finances. Revenue losses resulting from weaker economic growth combined with demands for Government to undertake countercyclical expenditure measures, such as additional funding for job creation or social assistance, could place significant upward pressure on the projected deficit levels.

Assuming that revenues continue to grow at their historical rate of 90 per cent of GDP growth over the projected period, revenues would fall as a share of the economy. Expenditures continuing to grow at 8.7 per cent in a moderating economy would result in expenditures increasing as a share of the economy. With the share of revenues falling and the share of expenditures rising, the deficit would also increase as a per cent of the economy. These trends are illustrated in the following graph.

REVENUE, EXPENDITURE AND DEFICIT AS A SHARE OF ECONOMY[1]



1 Does not include impact of the GST.
Source: Ontario Ministry of Treasury and Economics.

The projection as discussed above does not include the impact of the proposed federal Goods and Services Tax (GST). This federal proposal would affect the Province's finances in many ways.

For example, on the revenue side, the proposed one point reduction in the federal personal income tax rate, and anticipated increases in unemployment resulting from the GST over the forecast period, would result in a reduction in Personal Income Tax revenues to Ontario. The federal government is also proposing that the GST apply to provincial lottery profits, reducing revenues from that source.

The GST inflationary impact would increase the cost of delivering Provincial services. Higher unemployment can be expected to increase the cost of current programs to assist the unemployed. Some off budget expenditures, for example, indexed public sector pensions and Workers' Compensation benefits, would also be affected by an increase in the inflation rate.

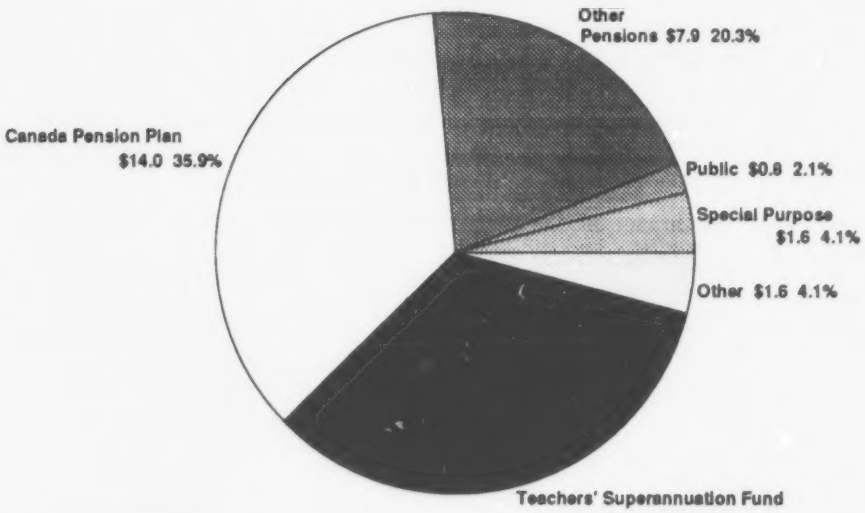
The financial position of our major transfer partners -- municipalities, universities, colleges, schools and hospitals -- would also be affected by the GST. The federal Minister of Finance has undertaken that the reform of this federal sales tax will impose no greater burden than before reform. The Province remains concerned that the federal government proposal to first levy the GST at 9 per cent on all purchases and subsequently provide partial GST rebates to these institutions will make the achievement of this commitment questionable. For example, the tax-partial rebate method will have negative cash flow consequences for these institutions.

While the exact financial impact of the proposed GST depends on a number of factors, the net effect of the tax on Ontario's fiscal position over the forecast period would be negative, and could be large.

Debt and Debt Financing*

Ontario's Debt

COMPOSITION OF ONTARIO'S OWN-PURPOSE TOTAL DEBT
MARCH 31, 1989
($ BILLION)


Other Pensions $7.9 20.3%
Canada Pension Plan $14.0 35.9%
Public $0.8 2.1%
Special Purpose $1.6 4.1%
Other $1.6 4.1%
Teachers' Superannuation Fund $13.1 33.6%

Source: Ontario Ministry of Treasury and Economics

Ontario's total debt, at $39.0 billion as of March 31, 1989, includes all Provincial liabilities issued for Provincial purposes. It is comprised of debentures, notes and treasury bills of $29.5 billion, pension and related benefit fund liabilities of $7.9 billion, and $1.6 billion of Special Purpose Accounts, mainly deposits with the Province of Ontario Savings Office.

Ontario's debt is concentrated in pension liabilities, with the largest proportions owed to the Canada Pension Plan (CPP) and the Teachers' Superannuation Fund (TSF). Debt owed to the general public constitutes only 2.1 per cent of the Province's total debt, while the liabilities of the Special Purpose Accounts total 4.1 per cent.

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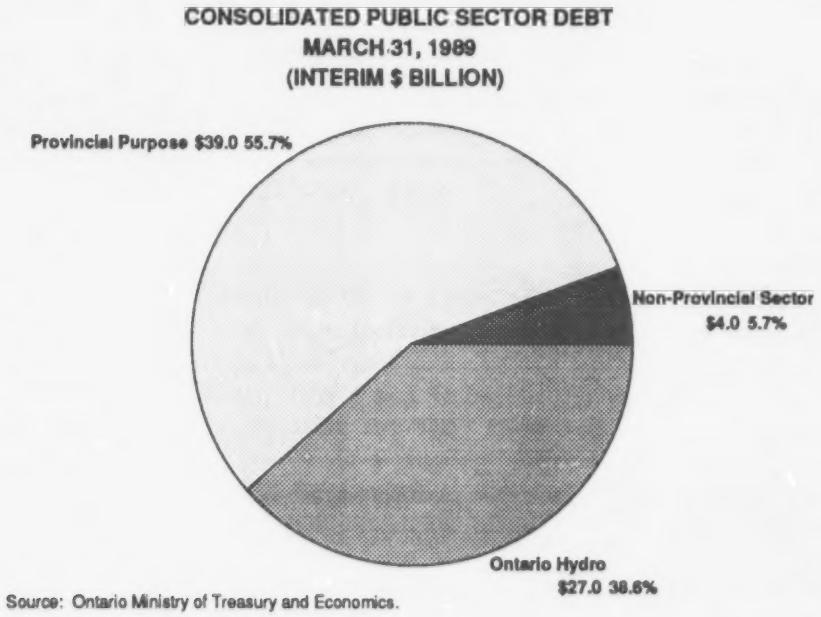
* All Ontario debt figures for 1989-90 are based on the September 30, 1989 Ontario Finances.

Consolidated Public Sector Debt



Source: Ontario Ministry of Treasury and Economics.

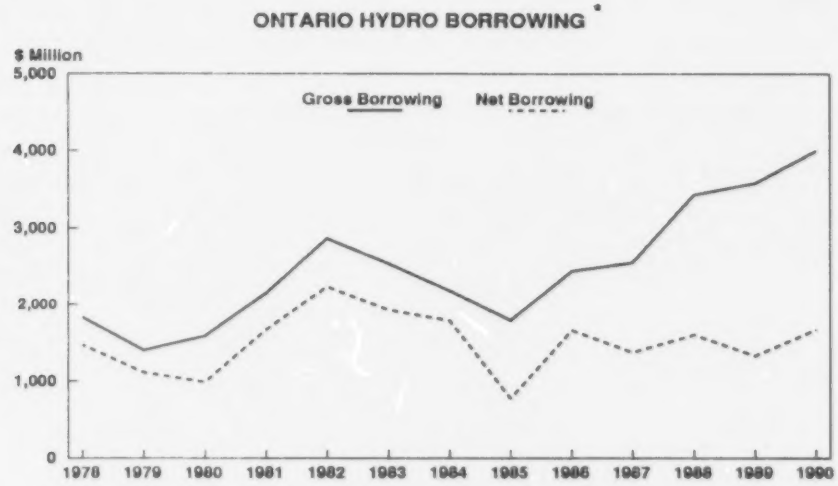
The broadest measure of debt in the Ontario Public Sector is Consolidated Public Sector Debt, which includes debt incurred at all levels of Provincial jurisdiction. As of March 31, 1989, Consolidated Public Sector Debt is estimated to have reached $70.0 billion. This debt measure has been restated to include Ontario's debt to pensions and related benefit funds and Special Purpose Accounts.

The preponderance of Provincial and Provincially-guaranteed debt in this measure illustrates Ontario's practice of centralizing public sector financing at the Provincial level. Ontario's direct and guaranteed debt, which is over 90 per cent of the consolidated debt, consists of obligations for the Province's own purpose and for Ontario Hydro. Given the prominence of Ontario's practice of centralized financing, there has been a limited requirement for public borrowing by municipalities, school boards, universities, colleges and hospitals. Internal funds and Provincial grants finance a large proportion of local capital expenditures, with the remainder financed through borrowing. Local government debt is about four per cent of consolidated debt, while less than one-half of one per cent consists of the liabilities of universities, colleges and hospitals. The Provincial share of Consolidated Public Sector Debt (direct and guaranteed) has been rising over time, reflecting the centralized approach to financing.

Hydro Borrowing

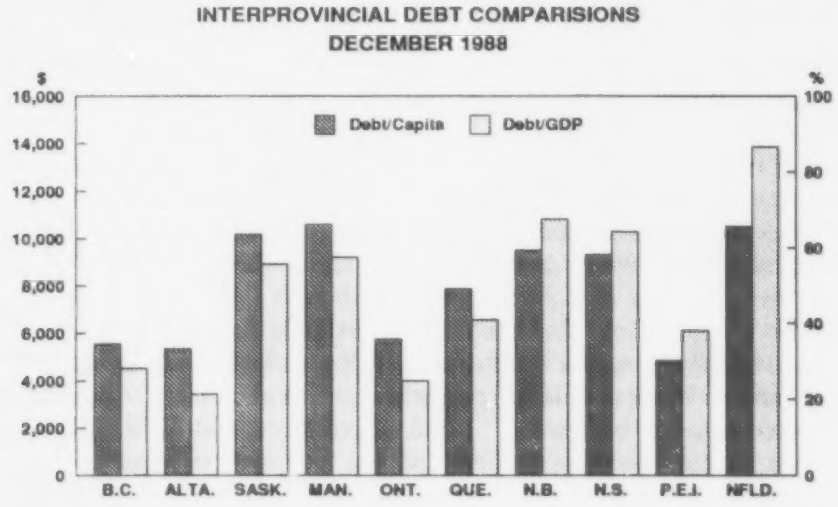
Ontario Hydro's annual gross borrowing is expected to be around $3.6 billion in 1989 and $4.0 billion in 1990, with borrowing net of retirements amounting to $1.3 billion in 1989

and $1.7 billion in 1990. The Province monitors Hydro's financing needs and ensures that they are consistent with the Province's fiscal and financing plans.



* 1978 to 1988 are actual figures, 1989 are interim figures and 1990 are forecasted figures.
Source: Ontario Hydro.

Interprovincial Debt Comparison



Source: Bank of Canada and Ontario Ministry of Treasury and Economics.

Interjurisdictional debt comparisons usually focus on direct and guaranteed debt measures because this assures a standard of conceptual uniformity and comparability across jurisdictions and over time. Nevertheless, the comparisons remain limited by exclusion of pension fund

deposits and certain other borrowings, and by differences in treatment across provinces of sinking funds and purchases by public sector investment funds, such as the Alberta Heritage Savings Trust Fund.

Ontario's direct and guaranteed debt measures are relatively low compared to other provinces. In 1988, Ontario owed $5,716 per person. This was the fourth-lowest level of direct and guaranteed debt per capita in Canada, higher only than Prince Edward Island, Alberta and British Columbia. Ontario had the second-lowest level of direct and guaranteed debt as a percentage of GDP (25.0 per cent), after Alberta.

Ontario's Financing

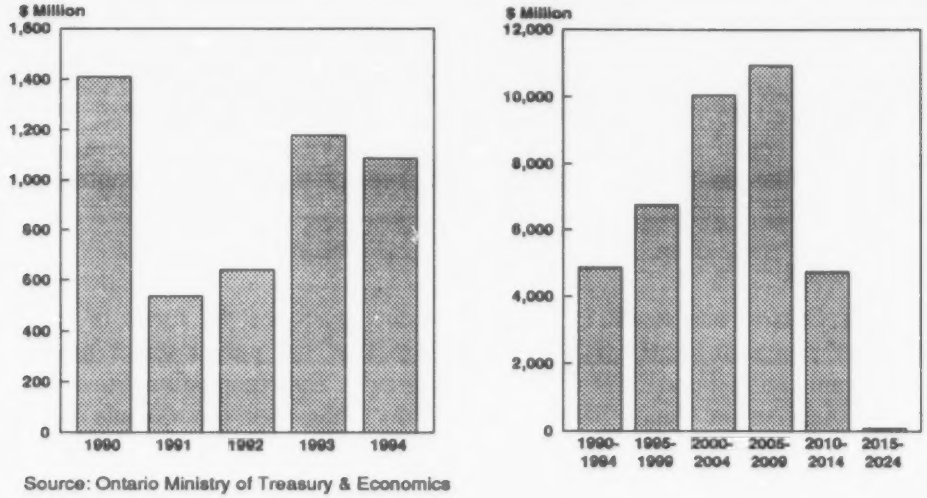
The Province of Ontario has available for its financing purposes the funds of the domestic and international capital markets, as well as the funds of the public sector pensions: the Teachers' Superannuation Fund (TSF), the Public Service Superannuation Fund (PSSF), the Superannuation Adjustment Fund (SAF), and Ontario's share of the Canada Pension Plan (CPP). Since the legislation governing the TSF, PSSF and SAF has required Ontario to borrow from these funds, they have been a growing source of financing for Ontario to date. In the past three years, availability of non-public sources of funds exceeded the Province's needs. Consequently, Ontario has declined almost all of the CPP funds available to it. CPP funds not required by the Province have been offered to Ontario Hydro. To date, in 1989-90, the Province has borrowed $651 million from the CPP on behalf of Ontario Hydro. In addition, the Province will make $3 billion of CPP funds available to aid in the provision of 30,000 units of non-profit housing over the next 3-5 years, and up to $200 million of CPP funds to Ontario school boards for capital requirements.

The Ontario Government has proposed legislation which will fundamentally change Ontario's current borrowing arrangements. Under the proposed legislation, beginning January 1, 1990, the teachers' and public service pension plans would invest their net cash flow in public capital markets. Ontario's borrowing requirements, if any, in and beyond 1990-91 are expected to be met through public borrowing.

Ontario's Maturing Debt

Approximately 13 per cent of Ontario's own-purpose debt is scheduled to mature in the five-year period from April 1990 to March 1994, and 31 per cent in the ten years from 1990 to 1999. In the five-year period ending March 1994, maturities will total $4.8 billion, with about 53 per cent representing retirements of Canada Pension Plan liabilities.

ONTARIO DEBT MATURITY



Source: Ontario Ministry of Treasury & Economics

Credit Worthiness

Provincial Ratings
October 1989

Table 6

	Standard and Poor's (S&P)	Moody's	Canadian Bond Rating Service (CBRS)	Dominion Bond Rating Service (DBRS)
British Columbia	AA+	Aa1	AA+	AA
Alberta	AA+	Aa1	AA	AA
Saskatchewan	AA -	A1	AA -	A (high)
Manitoba	A+	A1	AA -	A
Ontario	AAA	Aaa	AAA	AA
Quebec	AA -	Aa3	A	A (high)
New Brunswick	A+	A1	A	A
Nova Scotia	A -	A2	A -	A (low)
Prince Edward Island	NR*	A3	BBB+	A (low)
Newfoundland	A -	Baa1	BBB	BBB

* Not Rated.

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Dominion Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

Ontario is the only Canadian province assigned Triple A by three credit rating agencies (Standard and Poor's, Moody's and the Canadian Bond Rating Service). The Province shares Dominion Bond Rating Service's highest provincial rating (AA) with Alberta and British Columbia.

Rating Adjustments in 1988 and 1989 **Table 7**

		Rating Change
British Columbia	Upgraded from:	AA to AA+ (S&P) Aa2 to Aa1 (Moody's) AA to AA+ (CBRS) AA(low) to AA (DBRS)
Manitoba	Upgraded from:	A(low) to A (DBRS)
Ontario	Upgraded from:	AA+ to AAA (S&P)

Source: Ontario Ministry of Treasury and Economics, Canadian Bond Rating Service, Moody's Bond Survey and Standard and Poor's CreditWeek.

Federal-Provincial Funding Programs

The following sections describe the two major programs through which the provinces now receive federal funding: Federal-Provincial fiscal arrangements and the Canada Assistance Plan.

Federal-Provincial Fiscal Arrangements

Introduction

The federal-provincial fiscal arrangements are the institutional vehicles through which the federal government transfers funds to the provinces as part of its historical commitment to certain national shared-cost programs, and to the principle of interprovincial fiscal capacity equalization. The largest of these payments is made in respect of health care and post-secondary education under Established Programs Financing (EPF). Funds are also transferred under the Fiscal Equalization program, the Fiscal Stabilization program, and the Personal Income Tax Revenue Guarantee.

Although often discussed in terms of federal-provincial negotiation and agreement, the fiscal arrangements are under the sole legislative and administrative control of the federal government. Legislation in this area is drafted and enacted by the federal government, and requires no provincial enabling legislation, support or even agreement to operate.

Established Programs Financing

Adopted in 1977 to replace the federal-provincial shared-cost programs in the fields of health and post-secondary education, EPF was regarded as a milestone in co-operative federalism in Canada. The essence of the new arrangement was that the provinces, long dissatisfied with the cumbersome and inflexible nature of the cost-sharing arrangements, were given greater policy and administrative latitude through a move to block funding. At the same time, Ottawa lessened its financial risk by tying its contributions to the rate of growth of the national economy rather than to provincial expenditures.

Shortly after the new arrangement had been agreed upon, the federal government decided to keep track of the individual cash components of the transfers for health and post-secondary education. While not consistent with the principle of block funding, the split was for federal bookkeeping purposes only and did not require provinces to demonstrate that they had, in fact, spent the funds in these areas.

The *Canada Health Act*, passed by Parliament in 1984, sets program criteria and conditions of payment for the cash portion of transfers paid to the provinces for insured health care services and extended health care. Under the terms of the legislation, each province's health insurance plan must satisfy federal requirements respecting comprehensiveness, portability, universality, accessibility and public administration.

The federal government is empowered to withhold a portion of the provincial transfer payments equal to the amount that physicians bill above the rates set out in the provincial

fee schedules. Dollar for dollar deductions are also imposed on provinces that permit user charges. Between July 1984 and June 1986, over $106 million in payments to Ontario were withheld by the federal government. The Province has since complied with the conditions of the *Canada Health Act* by eliminating extra-billing for insured health services and has recouped the amount withheld.

As shown in Table 8, the federal government has taken a number of further actions to restrain the growth of its payments to the provinces. When the fiscal arrangements were amended in 1982, the Revenue Guarantee Compensation, which was built into EPF as part of the 1977 agreement, was removed. This effectively eliminated a portion of the per capita entitlements.

EPF transfer growth is based on both growth in the economy and population increases for individual provinces. Under the two-year federal "6 & 5" restraint program introduced in June 1982, per capita limits were imposed on post-secondary education transfer growth.

The federal government's Bill C-96 received Royal Assent in June 1986. It reduced the annual growth in per capita EPF transfers by two percentage points.

More recently, the federal government's Bill C-33, *An Act to amend the Federal-Provincial Fiscal Arrangements and Federal Post-Secondary Education and Health Contributions Act*, received First Reading on June 27, 1989. If passed, it would reduce the annual growth in per capita EPF transfers by an additional one percentage point, beginning in 1990-91. Taken together, the reductions in EPF entitlements for Ontario exceed $1.2 billion in 1989-90, and will amount to almost $1.6 billion in 1990-91. EPF cash payments to Ontario, which represent about seven per cent of total budgetary revenue, are expected to be $2.7 billion in 1989-90.

Ontario Losses Due To Federal Reductions in Annual EPF[1] Growth Since 1982 **Table 8**
($ Million)

	Elimination of Revenue Guarantee Compensation	"6 & 5" Caps on PSE[2] Transfers	1986-87 Reduction of EPF[1] Escalator	1990-91 Reduction of EPF[1] Escalator	Total Ontario	Total All Prov.[3]
1982-83	293	-	-	-	293	827
1983-84	323	41	-	-	365	1,027
1984-85	354	90	-	-	444	1,246
1985-86	382	98	-	-	480	1,341
1986-87	417	106	114	-	637	1,772
1987-88[4]	452	115	245	-	812	2,246
1988-89[4]	489	125	396	-	1,010	2,776
1989-90[4]	531	136	567	-	1,234	3,380
1990-91[5]	580	148	766	74[6]	1,568	4,270
TOTAL	3,821	860	2,088	74	6,842	18,884

1 Established Programs Financing.
2 Post-Secondary Education.
3 Includes Territories.
4 Based on federal interim estimates of EPF entitlements.
5 Forecast.
6 Provincial/territorial losses resulting from the latest federal EPF reduction will total an estimated $200 million in 1990-91.
Note: Figures may not add due to rounding.
Source: Department of Finance, Canada; Ontario Ministry of Treasury and Economics.

Federal support for Ontario health and post-secondary education programs has fallen from a peak of 52 per cent of provincial-local spending for these purposes in 1979-80 to under 38 per cent in 1989-90.

Equalization

Equalization payments are unconditional transfers from the federal government to qualifying provinces with the purpose, as enshrined in Section 36 of the *Constitution Act, 1982*, of ensuring that provincial governments have sufficient revenues to provide "reasonably comparable levels of public services at reasonably comparable levels of taxation". The actual determination of equalization entitlements has evolved over the years by refinements and adjustments to the formula since the inception of the program in 1957. Although there have been disagreements about these changes, some of which have had quite dramatic effects, all provinces have supported the overall thrust of the Fiscal Equalization Program.

Ontario has never received equalization payments. Indeed, when oil price shocks created the possibility of Ontario receiving equalization payments, these equalization payments were prevented through a retroactive legislative amendment in 1981.

The current "five-province standard" of fiscal capacity replaced a national average standard in 1982. This change, combined with a number of tax base modifications, tended to disadvantage Quebec and Manitoba. Accordingly, a transitional guarantee was incorporated into the formula. The transitional guarantee provided that no province could receive less under the new formula than it received in the last year of the old formula. Provision was made for a specified amount of growth.

As Table 9 illustrates, all provinces except Alberta, British Columbia and Ontario receive federal equalization transfers.

Estimated Equalization Entitlements by Province, 1989-90 **Table 9**

	($ Million)	($ Per Capita)
Newfoundland	910	1,602
Prince Edward Island	184	1,415
Nova Scotia	854	961
New Brunswick	836	1,165
Quebec	3,449	517
Manitoba	768	703
Saskatchewan	351	346
Total	7,353	664

Notes: 1 Figures may not add due to rounding.
2 Ontario, Alberta and British Columbia do not receive equalization payments.
Source: Department of Finance, Canada: Provincial Fiscal Equalization, First Estimate, 1989-90 (January, 1989).

For 1989-90, the current estimate of total equalization entitlements is $7.4 billion. The sole legislative constraint on the growth of equalization entitlements is that aggregate transfers must not exceed the year-over-year increase in GNP. So far, this ceiling has not had to be applied. Although Quebec receives the highest absolute share of total equalization ($3.4 billion), its per capita share ($517) is second-lowest among recipient provinces.

Fiscal Stabilization

In order to protect provinces from sudden year-over-year losses in revenue resulting from an economic downturn, the federal government has provided for Fiscal Stabilization payments. These unconditional cash transfers ensure that each province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will not be less than they were in the previous year.

In 1987-88, the federal government introduced, among other technical changes, an annual ceiling of $60 per capita for grant assistance. Fiscal Stabilization entitlements exceeding this limit are provided as interest-free loans repayable within five years. To date, two provinces have received payments under this program. British Columbia received $175 million in respect of the 1982-83 fiscal year and Alberta has received a $75 million interim payment as part of an unresolved claim for 1986-87. However, Fiscal Stabilization payments provide an important guarantee for many provinces.

Personal Income Tax Revenue Guarantee

Since provinces set Personal Income Tax rates in relation to the Basic Federal Tax, the federal Personal Income Tax Revenue Guarantee provides limited compensation to provinces when federal tax policy changes reduce provincial revenues within a taxation year. Compensation is provided for the amount that Personal Income Tax revenue losses exceed 1.0 per cent of basic federal tax for the province. The only Revenue Guarantee payment made to date has been $4.3 million to Saskatchewan in respect of the 1985 taxation year.

Canada Assistance Plan

The Canada Assistance Plan (CAP) was established by federal legislation in 1966 as a cost-sharing mechanism for provincially-administered social assistance and welfare programs. The Canada Assistance Plan replaced the targeted shared-cost programs that provided assistance for the elderly, the blind, the disabled and the unemployed. By the end of the 1960s, these programs had come under increasing criticism for their eligibility restrictions. The new program was designed to bring a measure of order and coherence to fragmented provincial public assistance systems.

Since its inception, federal payments under CAP have increased from $0.3 billion in 1967-68 to an estimated $4.8 billion in 1989-90 according to Canada Main Estimates. This makes CAP the third-largest source of transfer payments to the provinces after Established Programs Financing and Equalization. Ontario revenue from CAP is expected to total $1.8 billion* in 1989-90.

The Canada Assistance Plan is intended to act as a safety net. Under its provisions, the federal government contributes an amount equal to 50 per cent of provincial expenditures on assistance payments (food, shelter and clothing) to individuals in need, and on a range of services, including child welfare, child care, homemaker services for the elderly, institutions for the disabled and family counselling. To qualify for federal CAP funds, provincial welfare service programs must be designed to benefit those "in need or likely to become in need". As well, potential beneficiaries must demonstrate their eligibility through either a needs test or an income test, as determined by each province and subject to federal guidelines.

The Canada Assistance Plan has been the subject of numerous reviews during the last two decades. In 1970-71, the Senate Committee on Poverty issued a report that was critical of CAP and recommended that it be replaced by a guaranteed annual income. Ten years later,

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* Includes Civil Legal Aid.

negotiations were underway to remove social services from CAP and provide them through a block fund under a proposed *Social Services Financing Act*, modelled after the Established Programs Financing. The proposal, however, was withdrawn when the provinces refused to accept a reduction in the Established Programs Financing escalator to GNP growth less one per cent. The proposal to replace the federal share of CAP and other federal tax and transfer programs, such as family allowances and child tax credits, with a guaranteed annual income, was resurrected by the Macdonald Commission in 1985 when it recommended the adoption of a Universal Income Security Program.

More recently, the Nielsen Task Force on Program Review found no support for a major revision of CAP. However, its report did register concern over the trend toward long-term dependence on assistance among "employables" and warned of the danger that future CAP costs may become unaffordable as a result. The Nielsen review concluded that it may be necessary to change the open-ended nature of CAP funding by limiting federal spending under the agreement. However, the Canada Assistance Plan remains a singular example of intergovernmental collaboration and cost-sharing of major social programs available across Canada.

Canada Child Care Act

Provincial child care expenditures for this fiscal year are estimated at $364 million, an increase of 310 per cent from the 1984-85 level.

On September 26, 1988, the House of Commons passed the *Canada Child Care Act*, to enable the federal government to enter into cost-sharing agreements to contribute to provincial child care programs. The Act died during Senate review with the September 30 dissolution of Parliament, and has not been reintroduced.

The proposed *Canada Child Care Act* would have provided for the replacement of open-ended contributions to Ontario child care programs with a maximum $1.7 billion in federal program contributions over the 1988 to 1995 period. Subject to annual federal funding limits, Ottawa's contributions would have included 75 per cent reimbursements for capital grants for approved not-for-profit child care facilities, as well as 50 per cent reimbursements for operating grants for all approved child care centres.

Provinces would have maintained the option to continue current federal cost-sharing of child care expenditures under the Canada Assistance Plan as an alternative to converting to an arrangement under the proposed *Canada Child Care Act*.

The 1989 federal budget announced a deferral of new cost-sharing arrangements for provincial child care programs, with a commitment by the federal government to act to meet its child care objectives before the end of its term of office. In the interim, the Canada Assistance Plan will continue to share the cost of eligible Ontario child care services.

Provincial-Local Transfers

In 1989-90, the Province will provide close to $4.5 billion in financial support to municipalities and municipal agencies, as indicated in Table 10.

Provincial support to school boards also amounts to almost $4.5 billion, including nearly $310 million in capital assistance.

Highlights of Provincial Transfers to Local Governments **Table 10**
($ Million)

	Budget Outlook 1989-90
Transfers to Municipalities	
Unconditional	871
Roads	678
Transit	393
Social Services	1,571
Health	219
Environmental	184
Recreational & Cultural	92
Other*	490
Total Municipal Transfers	4,498
Transfers to School Boards	
General Legislative Grants**	4,153
Capital Grants	310
Total School Transfers	4,463
Total Transfers Allocated	8,961
Advances***	(413)
Total Transfers to Local Government	8,548

* Includes additional funding for northern roads from the Ministry of Northern Development and Mines.

** An additional $7.5 million was added to the Ministry of Education allocation in the 1989-90 Printed Estimates.

*** For 1988-89, $300 million for school capital grants and $413 million for Unconditional Grants were advanced from 1989-90. For 1989-90, the $300 million allocated for school capital grants will be advanced from 1990-91.

Source: Ontario Ministry of Treasury and Economics.

Transfers to Municipalities

Transfer payments to municipalities are estimated to increase by $333 million over 1988-89 levels, to $4.5 billion in 1989-90. This represents an increase of almost 8 per cent.

The Province provides financial assistance to municipalities through conditional and unconditional grant payments. Conditional grants are generally provided on the stipulation that these funds be used for a specific program or service within the municipality. Conditional grants are subject to eligibility criteria and spending conditions and municipalities are often required to contribute financially to the program. The majority of conditional grants are for transportation, health, social services, the environment, and culture and recreation.

Unconditional grants, on the other hand, provide financial assistance to municipalities that may be spent in any manner decided by municipal council. These grants are delivered through the Ontario Unconditional Grants Program.

The Province advanced $413 million of 1989-90 Unconditional Grants entitlements to municipalities in 1988-89. This initiative provided a cash flow advantage to municipalities. For 1989-90, Unconditional Grants payments are being maintained at their 1988-89 levels.

At present, both the conditional and unconditional grants programs are being reviewed by the Province with the aim of developing a more efficient, equitable and responsive system for delivering grants. Recently, an Advisory Committee on Provincial-Municipal Financing Matters was established to provide advice to the Minister of Municipal Affairs in exploring creative responses to financing pressures faced by both levels of government. One of the Committee's directives is to provide recommendations concerning the transfer payments system.

The average annual growth in Provincial support to the municipal sector has significantly outpaced inflation in Ontario over the last five years. As Table 11 indicates, total operating transfers increased by more than twice the rate of inflation (4.3 per cent). This reflected increased Provincial support in areas such as health and social services.

Provincial Transfers to Municipalities **Table 11**
($ Million)

	1984-85	Outlook 1989-90	Average Annual Increase (%)
Unconditional	720	871	3.9
Conditional	1,419	2,417	11.2
Operating	2,139	3,288	9.0
Capital	940	1,210	5.2
Total Transfers	3,079	4,498	7.9

Source: Ontario Ministry of Treasury and Economics.

The growth in capital transfers also outpaced inflation, reflecting increased Provincial capital activity in environmental and transit projects. Despite maintaining 1989-90 road grants at 1988-89 levels, road transfers have increased by about 34 per cent since 1984-85.

Municipal Sector Performance

Municipal spending in 1989 is expected to grow by 15.5 per cent, well above the compound average annual growth of about 10 per cent between 1984 and 1989. Capital spending, which accounts for less than a quarter of total expenditures, is expected to increase by 32 per cent. Growth continues to be led by areas served by regional governments. In general, these areas are experiencing above-average service growth as measured by the growth in households. It should also be noted that individual municipal patterns of growth within these areas can vary considerably. By comparison, Table 12 shows that, for municipalities not within regional governments, spending growth is expected to average only 7.1 per cent.

Estimated Municipal Spending, 1988 & 1989 **Table 12**
($ Million)

	Preliminary 1988	Projected 1989	Increase %
Municipalities within Metropolitan Toronto*	3,991	4,731	18.5
Municipalities within Regions*	5,073	6,032	18.9
All Governments in Regions*	**9,064**	**10,763**	**18.7**
Municipalities within Counties*	2,701	2,915	7.9
Municipalities within Districts	772	806	4.4
All Other Governments	**3,473**	**3,721**	**7.1**
Total Municipal Sector	**12,537**	**14,484**	**15.5**

* Includes upper and lower tier governments.
Source: Ontario Ministry of Municipal Affairs.

As shown in Table 13, the proportion of municipal financing accounted for by transfers and municipal property taxes has dropped over the period, with the difference being made up by other revenues and user fees.

Municipal Revenue Mix **Table 13**
(Per Cent)

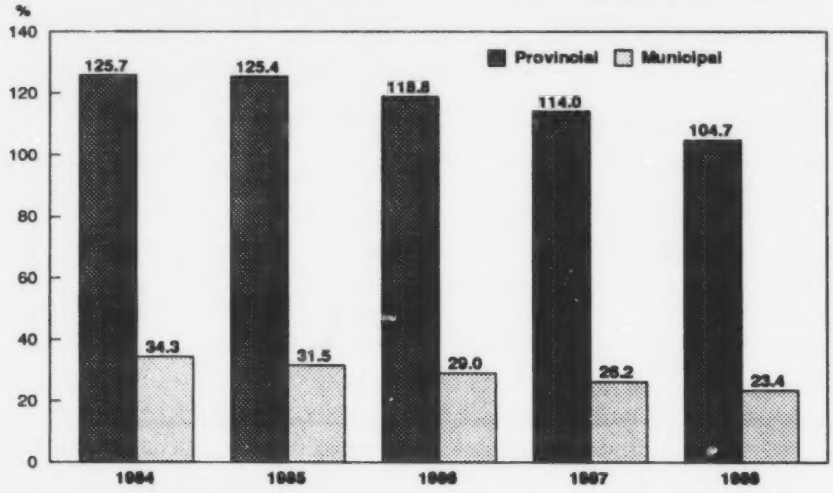
	1984	Projected 1989
Property Taxation*	40.4	38.5
Provincial Grants	32.1	28.0
All Other Revenues	27.5	33.5
	100.0	100.0

* Includes water and sewer billings.
Source: Ontario Ministry of Municipal Affairs.

As a group, municipalities are in a better position than the Province with respect to their debt burdens, although exceptions do exist on a case-by-case basis. (See the following chart.) "Debt" includes total long-term debt and Ministry of The Environment sewer and water project debt. In 1988, total municipal own-purpose debt was approximately $3 billion, slightly over

23 per cent of total annual revenues. By comparison, total Provincial own-purpose debt was approximately 105 per cent of annual budgetary revenue. Public debt interest payments are estimated at 10.8 per cent of annual revenues for the Province in 1988 -- higher than the 5 per cent estimated for municipalities.

OWN-PURPOSE DEBT AS A PER CENT OF ANNUAL REVENUE*



* 1988 Municipal Affairs' data is preliminary.

Sources: Ontario Ministry of Treasury and Economics and Ontario Ministry of Municipal Affairs.

Between 1987 and 1988, municipal long-term borrowing grew by 23.8 per cent and reached $458 million, reflecting strong growth in capital expenditures. This was a substantial increase over recent years (1984 to 1987) in which the compound average annual growth was 11.5 per cent.

Under the provisions of the Municipal Act, a municipality may not budget for a surplus or deficit in its revenue fund or operating account. The Ontario Municipal Board provides guidelines for measuring a municipality's ability to take on increased debt. As a general rule, the Board has determined that a municipality should not commit to spend more than 20 per cent of its annual operating expenditures on debt servicing. Despite the increase in borrowing, municipalities as a whole retain a significant capacity to assume debt for capital projects or other major requirements, although significant exceptions do exist particularly within the Greater Toronto Area. Table 14 shows the most recent estimates of municipal capacity to borrow funds, excluding debt assumed on behalf of school boards and Provincially-guaranteed debt.

Estimated Municipal Debt Capacity, 1988 **Table 14**
($ Million)

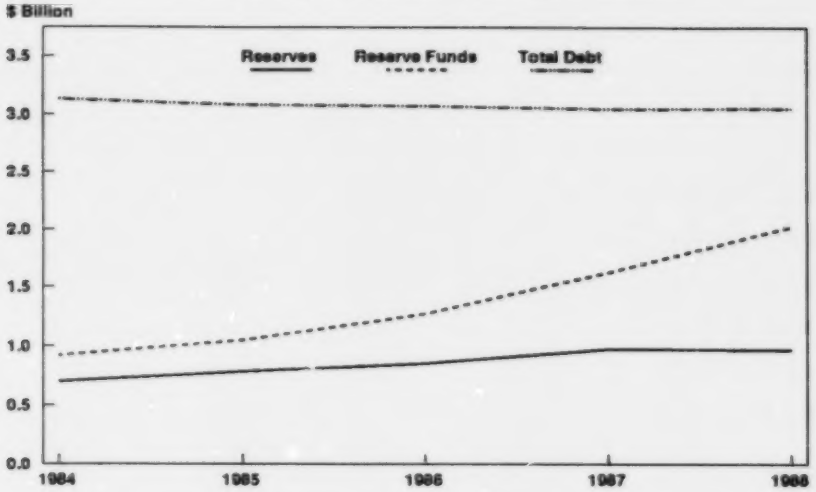
	Total Debt Capacity	Available Debt Capacity	
		$	%
Municipalities within Metropolitan Toronto*	3,382	2,512	74.3
Municipalities within Regions	3,589	2,453	68.3
All Governments in Regions*	**6,971**	**4,965**	**71.2**
Municipalities within Counties*	2,146	1,875	87.4
Municipalities within Districts	635	572	90.1
All Other Governments	**2,781**	**2,447**	**88.0**
Total Municipal Sector	**9,752**	**7,412**	**76.0**

* Includes upper and lower tier governments.
Source: Ontario Ministry of Municipal Affairs.

Municipal Reserves and Reserve Funds

The following chart shows that monies set aside in reserve funds grew steadily between 1983 and 1988. These are revenues set aside by municipalities to finance operating and capital expenditures at some future time. Reserves are generally used for such operating purposes as contingencies and sick-pay credit programs. Reserve funds are created by municipal councils for future capital projects. They represent an alternative to long-term borrowing for municipal councils.

TOTAL DEBT, RESERVE FUNDS AND RESERVES



Source: Financial Information Returns filed with the Ministry of Municipal Affairs, 1984 to 1988 (preliminary).

Education Finance

The funding of elementary and secondary education in Ontario is shared between the Province and local school boards. The Provincial share is distributed to school boards through the General Legislative Grants and capital programs with the school board share being raised from local property taxes.

Ontario is providing $4,161 million in operating grants to school boards in 1989-90. This is up 6.3 per cent from $3,914 million in 1988-89.

In addition, the Province has made a four-year commitment of $300 million per year for school capital beginning in 1989-90, for a total of $1,200 million. In 1989-90, $310 million has been allocated. This is up from $72 million in 1984-85, an increase of more than 300 per cent.

Bill 20, the *Development Charges Act*, is currently before the Legislature. This Act would give school boards the additional financing option of establishing lot levies for new school construction. Further, the Act provides for school boards and developers that wish to negotiate innovative financing arrangements, as an alternative to lot levies. A related piece of legislation entitled Bill 18, an Act to amend the *Ontario Municipal Improvement Corporation Act*, will give school boards access to $200 million in lower-cost Canada Pension Plan financing for school construction.

School funding is a significant component of government spending at both levels, as shown in Table 15.

Education Finance in Perspective **Table 15**
(Per Cent)

	Outlook 1989-90
Transfer Payments to School Boards	
Relative to Total Local Transfers	49.9
Relative to Provincial Budgetary Expenditure	10.8
School Finance in the Local Sector	
School Board Operating Spending Relative to Total Local Operating Spending	47.6
Average Residential School Taxes Relative to Total Property Taxes*	48.0

* On a per-household basis.
Source: Ontario Ministry of Treasury and Economics.

APPENDICES

I. Tax Expenditures

II. Fiscal Capacity and Tax Effort

III. Glossary of Terms

APPENDIX I

Tax Expenditures

Table 1

Personal Income Tax Expenditures
Estimates of Ontario Revenue Foregone
in the 1989 Taxation Year
($ Million)

	Ontario Revenue Foregone
Tax Expenditures Shared with the Federal Government	
Deductions and Exemptions	583
Registered Retirement Savings Plan Contributions	400
$100,000 Lifetime Capital Gains Exemption	272
Registered Pension Plan Contributions	260
Capital Gains Exclusion	117
Carrying Charges	64
Union Dues	46
Child Care Expenses	15
Moving Expenses	
Non-Refundable Tax Credits	3,123
Basic Personal Credit	300
Married Credit (including Equivalent-to-Married)	194
Age Credit	188
Charitable Donations	157
Canada Pension Plan Contributions	132
Unemployment Insurance Premiums	74
Credit for Dependent Children	49
Pension Income Credit	30
Medical Expenses	30
Disability Credit	25
Tuition Fees	10
Education Credit	
Tax Expenditures Solely Within Ontario's Jurisdiction (1989-90)	
Ontario Health Insurance Plan Premium Assistance*	595
Ontario Tax Grants to Seniors*	505
Ontario Property and Sales Tax Credits	444
Ontario Tax Reduction	40
Ontario Home Ownership Savings Plan Tax Credit	30
Ontario Political Contribution Tax Credit	5

* Although not directly part of the Personal Income Tax system, these tax expenditures provide benefits to individuals. OHIP premium payments and assistance end December 31, 1989.

Source: Ontario Ministry of Treasury and Economics.

Corporate Tax Expenditures **Table 2**
Estimates of Ontario Revenue Foregone in Full Year 1989-90
($ Million)

	Ontario Revenue Foregone
Corporate Income Tax	
Small Business Deduction	435
Capital Cost Allowance vs. Accounting Depreciation	210
Employer Health Tax (reduced rates for small employers)	190
Capital Gains Exclusion	150
Reduced Rate for Specified Sectors	88
Current Cost Adjustment	83
Research and Development Super Allowance	56
Exploration and Development Expenses	15
Resource Allowance	2
Small Business Development Corporations Program	1.3
Ontario Mineral Exploration Program	0.2
Capital Tax	
Flat Capital Tax for Small Business	100
Mining Tax	
Three-Year Mining Profits Tax Exemption for New Mines	5
$500,000 Mining Profits Exemption	3

Source: Ontario Ministry of Treasury and Economics.

Retail Sales Tax Expenditures **Table 3**
Estimates of Ontario Revenue Foregone in 1989-90
($ Million)

	Ontario Revenue Foregone
Services	
Professional	3,981
Commercial	2,189
Personal	1,831
Transient Accommodation	42
Admission fees	30
Goods	
Energy (including motive fuels)	1,836
Basic Groceries	1,200
Production Machinery	909
Reading Materials	168
Prepared Foods	120
Soil and Water	120
Prescription Drugs	110
Children's Clothing	60
Aircraft	57
Medical Equipment	28
Footwear	27
Feminine Hygiene Products	11
Purchaser Specific - All goods and services tax exempt or tax rebated	
Farmers	207
Visitors to Ontario	25
Hospitals	15
Religious/Charitable	11
Disabled Persons	8
Fisherpersons	1
Fur-trappers	1
Museums/Galleries	1
Municipalities (fire trucks)	1

Source: Ontario Ministry of Treasury and Economics.

Personal Income Tax Expenditures
1989 Tax Rules

Tax Expenditures Shared with the Federal Government

Deductions and Exemptions

Registered Retirement Savings Plan Contributions - Contributions are deductible from income up to prescribed limits. The allowable contribution for each year is governed by the maximum limit for that year ($7,500 in 1989), the individual's income and the amount of any contributions to a registered pension plan.

$100,000 Lifetime Capital Gains Exemption - Taxpayers are permitted a cumulative lifetime capital gains exemption of $100,000.

Registered Pension Plan Contributions - Employee contributions as required under the pension plan are deductible from income.

Capital Gains Exclusion - One-third of capital gains are income tax-exempt.

Carrying Charges - Individuals may deduct from income the interest cost on money borrowed to make investments, fees for investment counselling and other investment-related expenses.

Union Dues - Annual dues for membership in qualifying organizations are deductible from income.

Child Care Expenses - Expenses paid for child care services that enable single parents or both spouses in a two-parent family to earn income or attend an educational or training program are deductible from income. The maximum deduction is $4,000 for each child under the age of 7 and $2,000 for each child age 7 and over.

Moving Expenses - Unreimbursed moving expenses may be deducted from income by those who move at least 40 kilometres closer to their new workplace.

Non-Refundable Tax Credits*

Basic Personal Credit - A credit of $536 is available to every taxfiler.

Married Credit (including Equivalent-to-Married) - A credit of up to $447 is available to a taxfiler in respect of a dependent spouse or, if not married, in respect of an eligible dependent living with the taxfiler.

Age Credit - The age credit of $289 is available to all taxfilers age 65 and over.

Charitable Donations - A credit is available in respect of charitable donations and for gifts to Canada or a province, or for gifts of cultural property.

Canada Pension Plan Contributions - A credit of up to $46 is available for required contributions.

Unemployment Insurance Premiums - A credit of up to $54 is available for required premiums.

Credit for Dependent Children - A credit of $35 may be claimed in respect of each dependent child under age 19, with the credit doubled for the third and subsequent children in the family.

Pension Income Credit - This provision allows individuals, mostly seniors, to claim a credit of up to $88 in respect of their eligible pension income.

Medical Expenses - A credit is available in respect of out-of-pocket medical and dental expenses in excess of 3 per cent of Net Income.

Disability Credit - This credit of $289 is available to taxpayers who meet prescribed disability criteria.

Tuition Fees - A student may claim a credit in respect of eligible tuition fees, with any unused credit portion transferable to a supporting taxpayer.

Education Credit - This credit is for full-time students and is based on the number of months of attendance, with any unused credit portion transferable to a supporting taxpayer.

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* The income tax return does not show any amounts for Provincial non-refundable income tax credits. The value of these credits in respect of individual Ontario tax payable has been estimated by multiplying each federal credit by Ontario's tax rate of 52 per cent in 1989.

Tax Expenditures Solely Within Ontario's Jurisdiction

Ontario Health Insurance Plan Premium Assistance - This program eliminates or reduces OHIP pr niums for low-income families and specified groups.

Ontario Tax Grants to Seniors - Property tax grants of up to $600 and sales tax grants of $50 are available to those age 65 and over.

Ontario Property and Sales Tax Credits - This program provides refundable tax credits to low and moderate-income people under age 65 to reduce their property and sales tax burden.

Ontario Tax Reduction - This program eliminates or reduces Ontario Income Tax of up to $150 for low-income taxfilers.

Ontario Home Ownership Savings Plan Tax Credit - This program provides refundable tax credits of up to $500 for individuals and $1,000 for families saving for the purchase of a first home.

Ontario Political Contribution Tax Credit - A tax credit of up to $750 is available to offset a portion of contributions made to registered provincial political parties.

Corporate Tax Expenditures
1989 Tax Rules

Corporations Income Tax

Small Business Deduction - Canadian-controlled private corporations that qualify for the federal small business deduction are eligible for a reduction of the Ontario Corporations Income Tax rate to 10 per cent on the first $200,000 of eligible income annually.

Capital Cost Allowance vs. Accounting Depreciation - The capital cost allowance system allows companies to expense capital assets for tax purposes at a rate that generally exceeds accounting depreciation.

Capital Gains Exclusion - One-third of most capital gains are taxable, and one-third of capital losses can be used to offset taxable capital gains.

Reduced Rate for Specified Sectors - A one per cent tax rate reduction is provided for income earned from manufacturing, processing, mining, logging, farming, and fishing.

Current Cost Adjustment - Provides a direct deduction from income otherwise subject to tax equal to a percentage of the purchase price of new manufacturing and processing machinery and air and water pollution control equipment purchased for use in Ontario.

Research and Development Super Allowance - Provides a deduction from income otherwise subject to tax equal to a percentage of current and capital expenditures on research and development incurred in Ontario.

Exploration and Development Expenses - All Canadian and Ontario exploration and development expenses associated with mining activities are fully deductible.

Resource Allowance - Provides a tax deduction equal to a percentage of resource profits earned from the production of oil and gas and minerals.

Small Business Development Corporations Program - This program entitles investors to receive an Ontario Government grant (for individuals) or a tax credit (for corporations) based on the amount invested in eligible small businesses through an approved Small Business Development Corporation.

Ontario Mineral Exploration Program - Junior exploration companies, i.e. non-producing, may receive a tax credit or grant equal to 25 per cent of eligible exploration expenses.

Capital Tax

Flat Capital Tax for Small Business - Certain small corporations are either exempt from payment of capital tax or subject to a reduced flat rate of tax.

Mining Tax

Three-Year Mining Tax Exemption for New Mines - Income earned from a new mine or a major expansion of an existing mine is exempt from mining tax for the first three years of commercial production.

$500,000 Mining Income Exemption - An exemption is provided annually on the first $500,000 of mining income.

Retail Sales Tax Expenditures
1989 Tax Rules

Services

Professional - Professional fees are exempt from RST.

Commercial - Most commercial services are exempt from RST.

Personal - Most personal services are exempt from RST.

Transient Accommodation - Transient accommodation is taxed at a reduced rate of 5 per cent.

Admission Fees - All admission fees to places of amusement costing $4 or less and other specific events are exempt from RST.

Goods

Energy - All forms of energy, including motive fuels, are exempt from RST.

Basic Groceries - All grocery store food, except soft drinks, snack foods and confections, are exempt from RST.

Production Machinery - Production machinery and equipment and subsequent repairs are exempt from RST.

Reading Materials - Magazines purchased by subscription, books and newspapers are exempt from RST.

Prepared Foods - Prepared food priced at $4 or less is exempt from RST.

Soil and Water - Soil, clay, sand, gravel, unfinished stone and natural water are exempt from RST.

Prescription Drugs - All drugs prescribed by a doctor, dentist or veterinarian are exempt from RST.

Children's Clothing - Children's sized clothing is exempt from RST.

Aircraft - Commercial aircraft and parts, equipment and repairs for such aircraft are exempt from RST.

Medical Equipment - Hearing aids, dental and prescription optical appliances are exempt from RST.

Footwear - Footwear priced at $30 or less is exempt from RST.

Feminine Hygiene Products - Tampons, sanitary pads and sanitary belts are exempt from RST.

Purchaser Specific

Farmers - Most implements, machinery and repairs, and agricultural products are exempt from RST when purchased by a person engaged in farming.

Visitors to Ontario - Out-of-province visitors to Ontario are eligible for a refund of RST paid on certain items.

Hospitals - Medical and surgical equipment purchased by a hospital is exempt from RST.

Religious/Charitable - Used clothing and/or footwear sold by these organizations for $50 or less and meals sold at a nominal charge are exempt from RST. These organizations' purchases of publications, items used for worship, and construction materials are exempt from RST under certain conditions.

Disabled Persons - Most prosthetic and orthopaedic devices are exempt from RST. A rebate for RST paid on purchases of vehicles used to transport persons with physical disabilities is available, to a maximum of $1,600 for cars and $2,400 for vans.

Fisherpersons - Certain fishing equipment, including vessels, is exempt from RST when purchased by commercial fisherpersons.

Fur-Trappers - Trapping equipment purchased by a licensed trapper is exempt from RST.

Museums/Galleries - Works of art purchased by a museum or art gallery are exempt from RST if 50 per cent or more of the establishment's revenue is provided by public donations or grants.

Municipalities (fire trucks) - Fire-fighting vehicles priced at more than $1,000 and purchased for exclusive use of a municipality, public hospital, university, local service board or volunteer group are exempt from RST.

APPENDIX II

Fiscal Capacity and Tax Effort

Fiscal capacity measures the relative ability of a province to raise revenues from available revenue sources. Tax effort measures the relative extent to which each province taxes those available revenue sources. In this section, these measures are used to make interprovincial comparisons.

Determination of Fiscal Capacity

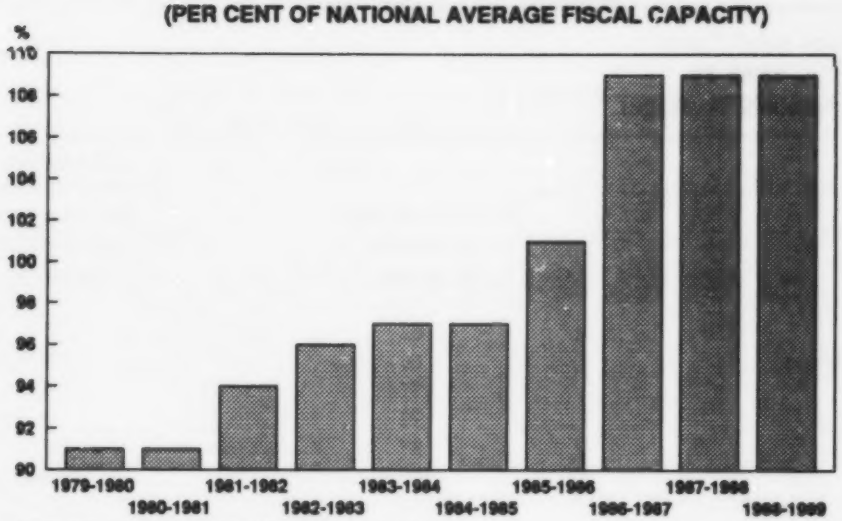
Fiscal capacity can be measured by a number of different indices.

The Representative Tax System (RTS) is the one used by the federal and provincial governments as a measurement of fiscal capacity. In the Representative Tax System, each revenue source has an associated tax base and the fiscal capacity can be related to population. For example, the base for tobacco taxes is the number of cigarettes sold in a province. If a province's share of a base is lower than its population share, that province is said to have a fiscal capacity deficiency in that tax base. If the opposite is true, a fiscal capacity surplus exists. In other words, a province has a fiscal capacity deficiency in a tax base if its per capita share of a base is less than the national average.

Tax bases are defined according to the taxing practices of provinces. For example, if an item such as infants' clothing is exempt from the retail sales tax in a majority of the provinces, such sales would not be included in the tax base. Hence, the term "representative".

Employing data from the federal Equalization Program, it is possible to derive an aggregate tax base share by adding together 37 different provincial and local tax bases. This provides a single, comprehensive measure of a province's relative fiscal capacity. In 1988-89, Ontario's fiscal capacity, measured on this basis for provincial-local own-source revenues, was 109 per cent of the national average. The chart below indicates how Ontario's fiscal capacity has varied over the past ten years.

FISCAL CAPACITY OF ONTARIO
(PER CENT OF NATIONAL AVERAGE FISCAL CAPACITY)



Notes: Data for 1987-88 and 1988-89 are subject to revision.
Index for 1987-88 is based on phased-in value of tax base change in 1987 Fiscal Arrangements Regulations.

Source: Department of Finance, Canada.

As Table 1 shows, own-source fiscal capacities in 1988-89 ranged from 62 per cent for Newfoundland to 137 per cent for Alberta. If federal transfer revenues are added to provincial-local own-source revenues, the fiscal capacity of "equalization-recipient" provinces approaches the national average. Since federal transfers are relatively large for the "equalization-recipient" provinces, the relative fiscal capacities of the "non-recipient" provinces decline. For example, Ontario's 1988-89 fiscal capacity declined 9 percentage points to 100 per cent of the national average, primarily because the Province does not receive federal equalization payments.

Indices of Provincial-Local Fiscal Capacity, 1988-89 **Table 1**
(Per Cent of National Average)

	Provincial-Local Own-Source Revenues	Provincial-Local Own-Source Revenues plus All Federal Transfers*
Newfoundland	62	95
Prince Edward Island	66	98
Nova Scotia	77	96
New Brunswick	72	98
Quebec	87	95
Ontario	**109**	**100**
Manitoba	83	94
Saskatchewan	90	95
Alberta	137	122
British Columbia	105	99
National Average	100	100

* Federal Transfers include federal 1988-89 Main Estimates only.
Note: Data are subject to revision.
Source: Department of Finance, Canada and Ontario Ministry of Treasury and Economics

Included in the determination of federal transfers are special contracting-out tax points that Quebec opted for in lieu of a portion of federal cash contributions under the Canada Assistance Plan and Hospital Insurance. The latter contributions were subsequently rolled into Established Programs Financing.

Determination of Tax Effort

A comparison of provincial tax rates on individual revenue sources (e.g., Sales Tax Rate) is often employed as a gauge of relative revenue-raising efforts. However, such comparisons alone do not provide a way of assessing a province's overall tax effort.

As with the determination of fiscal capacity, tax effort can be measured by individual revenue sources. For each revenue source, a national average tax rate can be calculated by dividing the provincial revenues collected by the total all-province tax base. A comprehensive measure of tax effort can then be calculated by dividing a province's share of total provincial-local revenues by its share of total tax base.

This measure of tax effort indicates to what extent a province is taxing what is available to be taxed, relative to the national average. Local revenues are included because of the varying

responsibilities that individual provinces allocate to their local governments. Table 2 provides the indices of relative tax effort for 1988-89 on this comprehensive basis.

Indices of Provincial-Local Tax Effort, 1988-89 **Table 2**
(Per Cent of National Average Tax Effort)

Newfoundland	99
Prince Edward Island	96
Nova Scotia	89
New Brunswick	96
Quebec	115
Ontario	**100**
Manitoba	111
Saskatchewan	103
Alberta	73
British Columbia	100
National Average	100

Note: Data are subject to revision.
Source: Department of Finance, Canada.

Ontario's overall tax effort is equal to the national average. Alberta's tax effort is about 27 per cent below the national average, mainly because it levies no sales tax and has the lowest personal income tax rates. Since Alberta's share of oil and gas revenues is about the same as its share of oil and gas tax bases, its resource taxation does not bias its tax effort.

Quebec has a very high tax effort, some 15 percentage points above the national average in 1988-89. Despite high rates of taxation on certain revenue sources, the Maritime provinces do not have a high degree of overall tax effort, due in large part to their relatively low levels of local property taxation.

APPENDIX III

Glossary of Terms

Ad Valorem Tax - A percentage-based tax, typically applied to a measure of value such as selling price.

Basic Federal Tax - The level of tax determined by applying the federal tax rate schedule to taxable income and subtracting non-refundable credits. It is not federal tax payable, which is basic tax adjusted by credits, surtaxes or reductions. Ontario's tax rate of 52 per cent in 1989 is applied to Basic Federal Tax to yield Basic Ontario Income Tax.

Canada Assistance Plan (CAP) - Federal-provincial cost-sharing mechanism for provincially-administered social assistance and welfare programs.

Capacity Utilization Rate - The ratio of actual output of an industry (plant, firm, or economy) to the output it could produce with its existing plant and equipment.

Computer-assisted design and computer-assisted manufacturing (CAD/CAM) - The use of electronic equipment to design and manufacture products. CAD/CAM permits design changes to be refined, tested and incorporated into manufacturing more quickly than traditional methods.

Consolidated Public Sector Debt - Debt incurred at all levels of Provincial jurisdiction, including the Province, Ontario Hydro, municipalities, hospitals, universities and colleges.

Consumer Price Index (CPI) - A monthly index measuring the retail prices of a fixed basket of goods and services purchased by consumers.

Consumption - The value of spending by consumers on goods and services, measured in current dollar terms (nominal) or adjusted for inflation (real). In Ontario, consumption accounts for approximately 55 per cent of Gross Domestic Product.

Cost-of-living Adjustment - An adjustment to incomes, wages or other payments to maintain previous purchasing power in the face of changing consumer prices.

Debt to Equity Ratio - The total debt of a corporation divided by its shareholders' total equity.

Deductions - Reductions in the income tax base, usually for specific expenses incurred in order to earn income.

Deficit - The amount by which budgetary expenditures exceed budgetary revenues.

Economies of Scale - Reductions in the average cost of production achieved by increasing the volume of output.

Equalization - Unconditional transfers from the federal government to qualifying provinces with the aim of ensuring that provincial governments have sufficient revenues to provide reasonably comparable levels of public service at reasonably comparable levels of taxation.

Established Programs Financing (EPF) - Federal block contributions to the provinces in respect of health care and post-secondary education.

Exemptions - Amounts deductible from income in recognition of specific personal circumstances or, in the case of sales taxes, items specifically excluded from the tax base.

Expenditures - Direct expenditures on government programs include payments for goods and services, interest on the public debt, salaries and employee benefits, transfer payments to individuals, municipalities and institutions, subsidies and grants, and the acquisition and construction of fixed assets.

Export - A good or service produced in one country or jurisdiction and sold to another.

Final Demand - Domestic and foreign purchases of goods and services produced for final use within the economy, excluding inventory change.

Final Domestic Demand - Purchases of goods and services for final use within the economy, excluding the foreign sector (exports and imports) and inventory change.

Fiscal Arrangements - Institutional vehicles through which the federal government transfers funds to the provinces as part of its commitment to shared-cost programs and interprovincial fiscal capacity equalization.

Fiscal Capacity - Measure of a province's ability to raise revenues from available revenue sources relative to other provinces.

Fiscal Policy - The use of the Government's spending and taxing power to affect the aggregate level of economic activity. Expansionary fiscal policy is generally characterized by an increase in discretionary spending or a tax cut.

Fiscal Stabilization - Unconditional cash transfers from the federal government to ensure that no province's tax revenues, measured on the basis of constant tax rates and structure, plus its equalization payments, will be less than they were in the previous year.

Greater Toronto Area (GTA) - Includes municipalities in the regions of Halton, Durham, Peel, York and Metropolitan Toronto.

Gross Borrowing - Total borrowing including borrowing necessary for debt retirement purposes.

Gross Domestic Product (GDP) - The value of goods and services produced within the geographic boundaries of an area, expressed either in current dollar value (nominal) or adjusted for inflation (real).

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Gross Borrowing - Total borrowing including borrowing necessary for debt retirement purposes.

Gross Domestic Product (GDP) - The value of goods and services produced within the geographic boundaries of an area, expressed either in current dollar value (nominal) or adjusted for inflation (real).

Gross National Product (GNP) - The value of a nation's total output of goods and services, expressed either in current dollar terms (nominal) or adjusted for inflation (real). The percentage change in real GNP is the usual measure of the real growth rate of the economy.

Group of Seven Countries - Canada, France, Italy, Japan, United Kingdom, United States and West Germany.

Guaranteed Debt - Debt which the Province agrees to honour if the borrowing party cannot or will not; primarily Ontario Hydro.

Household Formation - Net increases in new households in a period.

Import - A good or service which has been bought from another country or jurisdiction.

Inflation - A continuing rise in the general price level.

Interest Rate - The price paid (charged) by a borrower (lender) of money. Nominal interest rates are those actually paid; real interest rates are nominal rates less the expected rate of inflation. (Current rates of inflation are generally used as proxies for expected rates.)

Interest Service Ratio - Total interest payments taken as a per cent of cash flow of industrial corporations before interest and taxes are deducted.

Inventory - The total value of the various raw materials, goods in process, parts and finished goods held by a firm.

Inventory Accumulation - An increase in the level of inventories held in the economy.

Investment - The value of spending on capital goods such as houses, plant, machinery and equipment; may be measured in current dollar terms (nominal) or adjusted for inflation (real).

Just-in-time Production - A system of production in which parts are delivered to assembly plants when they are required, eliminating the need for warehousing by the assembler.

Labour Force - The total number of persons, age 15 and over, who are either employed or looking for work.

Marginal Tax Rates - A schedule of rates used to determine the amount of tax payable at various taxable income levels and on each additional dollar of taxable income.

Monetary Policy - The policies of the central bank (Canada - Bank of Canada; U.S. - Federal Reserve Board) that determine the availability and cost of credit (i.e., interest rates) in the economy. Tight (anti-inflationary) monetary policy restricts growth of the money supply, thus raising interest rates and reducing inflation by squeezing demand from the economy.

MUSH sector - Municipalities, universities, school boards, hospitals, colleges and libraries.

Net Borrowing - Gross borrowing less borrowing needed for debt retirements.

Net Cash Requirements or Surplus (NCR) - The sum of the deficit and the net balance of other accounts.

Net Migration - The difference between the total population coming into the province and the total population leaving.

New Industrialized Economies - Jurisdictions which have recently achieved middle-income status through rapid industrialization and surging exports. They include Hong Kong, Singapore, Taiwan and South Korea.

Nominal (GDP, consumption, investment, etc.) - Value in current dollars (i.e., not adjusted for inflation).

Non-Marketable Securities - Securities which may not be bought or sold in public capital markets.

Non-Public Borrowing - Borrowing from non-public sources of funds, usually pension funds like the Canada Pension Plan.

Numerically-controlled machine tools - Machine tools whose motions are controlled by computerized mathematical instructions, rather than directly by a human operator.

Operating Position - The difference between revenues and expenditures, excluding capital expenditures.

Organization for Economic Cooperation and Development (OECD) - An organization of industrial nations, with a permanent staff of officials, established in 1961 to improve trade and investment flows among its members, to analyze and deal with balance-of-payments and other economic problems and to coordinate foreign-aid policies.

Other Accounts - The lending, investment and special account administration activities of the Government, including loans, advances and investments, pension and related benefit funds and special purpose accounts. The transactions affect only asset and liability accounts.

Other Revenue - Total revenue minus taxation revenue and payments from the federal government. Major sources include OHIP premiums, LCBO and lottery profits, fees and licences and interest income.

Own-Purpose Debt - Debt issued by Ontario for Provincial purposes only. It excludes debt issued by Ontario on behalf of Ontario Hydro.

Paid-Up Capital - For most corporations, paid-up capital are funds invested in the corporation by its shareholders and other parties, loans or advances made to the corporation, and its cumulative undistributed corporate profit less its investment in other firms.

Participation Rate - The percentage of the population, age 15 and over, that is in the labour force.

Per Capita - Per person.

Per Point Yields - An estimate of direct revenue which would be gained or lost for a first unit change in tax rates.

Personal Disposable Income - The income remaining to persons for consumption or saving after deduction of income taxes and other legislated deductions, such as CPP premiums.

Personal Income - The income received by persons from all sources.

Personal Income Tax Revenue Guarantee - Federal program that compensates provinces when amendments to the federal *Income Tax Act* reduce, without notice, a province's Personal Income Tax revenues by more than one per cent of the Basic Federal Tax for the province.

Personal Savings Rate - Percentage of personal disposable income that is not spent on current consumption.

Prime Rate - The interest rate charged by chartered banks to their most credit-worthy customers.

Productivity - Output per unit of input (labour, capital, energy) employed.

Protectionism - Advocacy of protective tariffs and other barriers to trade as a means of developing national wealth.

Public Borrowing - Borrowing which is done through public capital markets.

Public Debt Interest - Interest paid by Ontario on total debt incurred for its own purpose.

Real (GDP, consumption, etc.) - Adjusted for inflation, constant dollar.

Recession - A downturn in the business cycle, characterized by weak economic activity and high unemployment. Two consecutive quarters of decline are generally considered to indicate a recession.

Recovery - The upturn of the business cycle following a recession, characterized by an increase in economic activity.

Representative Tax System - A series of thirty-seven distinct revenue sources used to determine what provinces, collectively, tax.

Revenue - Includes revenue raised through taxation, premiums, fees, licences and permits, payments from the federal government under the Fiscal Arrangements and shared-cost programs and income from investments.

Seasonal Adjustment (seasonally-adjusted) - A statistical adjustment to take account of seasonal factors, such as weather, so that data more accurately reflect underlying trends.

Specific Rate of Tax - A fixed rate per unit (e.g., gasoline is taxed at a rate of 10.3 cents per litre).

Surtax - A tax additional to Basic Ontario or Basic Federal Tax, usually calculated with reference to basic tax or to taxable income.

Tariff - A tax imposed on imported goods, levied either as a percentage of their value or according to the number of units imported.

Tax Base - The taxable value to which tax rates are applied (e.g., the taxable portion of income; or the value of goods and services taxed under the Retail Sales Tax).

Tax Collection Agreement - The agreement between each province and the federal government that authorizes the federal government to collect that province's Personal Income Tax. Under the current arrangements, the provinces agree to calculate their tax as a percentage of Basic Federal Tax, effectively waiving all rights to determine the tax base. Provinces are permitted limited credit and surtax/reduction programs. Some provinces have similar arrangements for Corporate Income Taxes.

Tax Credit - A reduction of certain taxes paid, with the amount of the credit determined by a specified formula. Ontario Tax Credits, for example, offset property and sales taxes for individuals by reducing Ontario Personal Income Taxes. The level of this credit is a function of both the amount of tax paid and the ability-to-pay of the individual. As a result, credit benefits fall as income rises, effectively redistributing tax burdens in favour of lower income individuals.

Tax Effort - Measure of the extent that a province actually taxes available revenue sources relative to other provinces.

Tax Expenditure - A specific incentive in the tax structure that reduces the normal amount of tax paid to a lower or zero amount.

Total Debt - Total liabilities of the Province issued for Provincial purposes.

Unemployment Rate - The number of persons in the labour market who are unemployed as a percentage of the labour force; may be either seasonally-adjusted or unadjusted (actual).

Unit Labour Cost - A measure of productivity calculated by dividing the total wage bill by the total number of units of a good or service produced.

Value-Added - The value of a firm's output minus the value of the inputs it purchases from other firms.

Review of Selected Financial and Economic Statistics
($ Million)

	1979-80	1980-81	1981-82	1982-83
Revenue	14,236	15,585	17,914	19,367
Expenditure	15,357	16,882	19,694	22,556
Deficit	1,121	1,297	1,780	3,189
Other Accounts - net	537	494	277	711
Net Cash Surplus/(Requirements)	(584)	(803)	(1,503)	(2,478)
Financial Position				
Total Debt	18,096	19,512	21,354	23,955
Provincial Debt Transactions - Proceeds net of Retirements	1,133	968	1,363	2,051
Gross Domestic Product (GDP) at Market Prices[1]	104,363	114,994	131,831	137,310
Personal Income[1]	84,607	94,411	110,033	122,443
Population - June ('000)	8,501	8,570	8,625	8,703
Total Debt per Capita (dollars)	2,128	2,277	2,475	2,752
Personal Income per Capita (dollars)	9,953	11,016	12,757	14,069
Expenditure as a per cent of GDP	14.7	14.7	14.9	16.4
Deficit as a per cent of GDP	1.1	1.1	1.4	2.3
NCR as a per cent of GDP	0.6	0.7	1.1	1.8
Total Debt as a per cent of GDP	17.3	17.0	16.2	17.4
Cumulative Net Borrowing for Ontario Hydro				
U.S.	4,506	4,379	5,573	6,058
C.P.P.	-	500	1,000	1,000
Contingent Liabilities (mainly Ontario Hydro)	7,904	8,553	9,284	11,122

1 Gross Domestic Product and Personal Income are calculated on a calendar year basis. The amounts appearing in a fiscal year column are for the preceding calendar year.

2 Ontario Finances, September 30, 1989.

Note: All funds are quoted in Canadian dollars.
N/A - not available.

Source: Ontario Ministry of Treasury and Economics.

1983-84	1984-85	1985-86	1986-87	1987-88	1988-89	Interim 1989-90[2]
21,412	23,893	26,240	29,544	32,453	37,256	40,726
24,565	26,452	28,854	32,178	34,942	38,735	41,296
3,153	2,559	2,614	2,634	2,489	1,479	570
864	857	1,009	1,286	1,203	1,429	1,047
(2,289)	(1,702)	(1,605)	(1,348)	(1,286)	(50)	477
27,406	30,041	32,904	35,103	36,981	39,014	39,952
2,860	2,090	2,102	1,194	901	700	(104)
151,945	171,499	186,166	204,700	225,428	249,497	271,177
131,947	146,193	158,388	170,480	188,338	206,399	225,064
8,798	8,902	9,006	9,113	9,265	9,426	9,570
3,116	3,374	3,654	3,852	3,991	4,139	4,175
14,997	16,422	17,587	18,707	20,327	21,896	23,517
16.2	15.5	15.5	15.7	15.6	15.5	15.2
2.1	1.5	1.4	1.3	1.1	0.6	0.2
1.5	1.0	0.9	0.7	0.6	0.2	0.1
18.0	17.6	17.7	17.2	16.5	15.6	14.7
6,487	7,206	7,189	6,667	6,033	5,692	N/A
1,000	1,000	1,000	1,119	1,508	2,097	N/A
12,711	14,220	15,963	17,603	18,595	20,559	N/A